SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1917.

No. 492.

EMANUEL J. DOYLE, COLLECTOR OF INTERNAL REVENUE, PETITIONER,

vs.

MITCHELL BROTHERS COMPANY.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

INDEX.

	Original.	Print.
Caption	A	1
Transcript of record from the District Court of the United States for the Western District of Michigan	1	1
Declaration	1	1
Plea	23	24
Opinion of the court (sessions J)	28	24
Judgment	33	27
Orders extending time	33	28
Bill of exceptions	34	28
Testimony of L. T. M. Foster	35	29
Plaintiff's Exhibit 8. Letter, Osborn to Mitchell Brothers, September 16, 1913	36	29
Plaintiff's Exhibit 14. Letter, Osborn to Morris, December 4, 1913	38	31
Plaintiff's Exhibit 18. Letter, Norris, McPherson & Harrington to Clapperton, collector, etc., December 22, 1913	39	32
Testimony of John Pfeifler	60	50
Darwin B. Kelly	64	53
Alfred W. Newark	65	54
Joseph Murphy	67	55
L. T. M. Foster (recalled)	67	56
Bruce Green	68	57
J. J. Wood	70	58
John Caldwell	71	58
Charles T. Mitchell	72	60
Henry Knowlton	88	73
L. T. M. Foster (recalled)	89	74

	Original.	Print.
Plaintiff's Exhibit 1. Return of net income received during year ending December 31, 1910, etc.	92	76
Plaintiff's Exhibit 2. Income tax return of plaintiff for year ending December 31, 1910	95	78
Plaintiff's Exhibit 3. Income tax return of plaintiff for year ending December 31, 1911	95	78
Plaintiff's Exhibit 4. Income tax return of plaintiff for year ending December 31, 1912	96	80
Plaintiff's Exhibit 24. Income statement, January 1, 1909	97	81
Plaintiff's Exhibit 25. Income statement, January 1, 1910	102	85
Plaintiff's Exhibit 26. Income statement, January 1, 1911	105	88
Plaintiff's Exhibit 27. Income statement, January 1, 1912	108	91
Plaintiff's Exhibit 33. Statement of material sold and certified to cedar products account	112	94
Proposed amendments to findings of fact	112	94
Findings of fact	115	96
Conclusions of law	128	110
Exceptions of defendant to the court's findings of fact and conclusions of law	137	117
Assignments of error	143	122
Petition for writ of error	147	125
Writ of error	148	126
Citation and service	149	126
Praecipe for transcript	149	127
Clerk's certificate	150	128
Order of argument and submission	151	128
Judgment	151	128
Opinion, Denison, J.	152	129
Petition for rehearing	169	136
Order denying petition for rehearing	174	139
Opinion, *per curiam*, on motion for rehearing	175	139
Clerk's certificate	176	139
Writ of certiorari and return	177	140

a No. 2864.

United States Circuit Court of Appeals, Sixth Circuit.

EMANUEL J. DOYLE, COLLECTOR OF INTERNAL REVENUE, PLAINTIFF IN ERROR,

vs.

MITCHELL BROTHERS COMPANY, DEFENDANT IN ERROR.

Error to the District Court of the United States for the Western District of Michigan.

Record. Original transcript filed November 16, 1915.

1 *Transcript of record.*

Declaration.—Filed October 17, 1914.

On filing declaration in this cause pursuant to the statute authorizing the commencement of suits by declaration, and on motion of Norris, McPherson, Harrington & Waer, attorneys for the plaintiff,

It is ordered that the defendant in said cause plead to the said declaration within fifteen (15) days after service of copy thereof and notice of this rule, or judgment, etc.

Dated October 17, 1914.

NORRIS, MCPHERSON, HARRINGTON & WAER,
Attorneys for Plaintiff.

Business Address: 721–730 Michigan Trust Co. Building, Grand Rapids, Michigan.

To the within named defendant:

Take notice, that on filing in the office of the clerk of said court as commencement of suit, a declaration in this cause, of which the within is a true copy, a rule to plead was filed therewith requiring you to appear and plead to the said declaration within fifteen (15) days after service on you of a copy thereof and notice of said rule, or judgment, etc.

Yours, etc.,

NORRIS, MCPHERSON, HARRINGTON & WAER,
Attorneys for Plaintiff.

Business Address: 721–730 Michigan Trust Co. Bldg., Grand Rapids, Michigan.

United States of America. The District Court of the United States for the Western District of Michigan, Southern Division.

Western District of Michigan, Southern Division, Wexford County, ss.: October Term, 1914, to wit, October 17, 1914.

Mitchell Brothers Company, plaintiff, by Norris, McPherson, Harrington & Waer, its attorneys, complains of Emanuel J. Doyle, as

United States Collector of Internal Revenue for the fourth collection district of Michigan, of a plea of trespass on the case upon premises, filing this declaration and rule to plead as commencement of suit, pursuant to the statute in such case made and provided.

For that whereas, the plaintiff, heretofore, to wit, on the 31st day of December, A. D. 1908, was, thence hitherto hath been, and still is,
2 a corporation organized and existing under the laws of the State of Michigan, and was, hence hitherto hath been, and still is, a citizen of the State of Michigan, and a resident of Cadillac, Wexford county, in said State.

And defendant, at the time of the commencement of this action, was a citizen of said State of Michigan, and a resident of Grand Rapids, in the county of Kent, in said District and Division of Michigan, and was Collector of Internal Revenue of the United States of America for the Fourth collection district of Michigan.

And plaintiff saith that, being a corporation as aforesaid, it was for each of the years 1909, 1910, 1911 and 1912, subject to and liable to pay to the United States of America the special excise tax with respect to the carrying on or doing business by plaintiff, imposed on plaintiff by section 38 of an act of Congress of the United States, entitled, "An Act to provide revenue, equalize duties and encourage the industries of the United States, and for other purposes," approved August 5, 1909, which tax in each of the years aforesaid was, by the act aforesaid, limited to an amount or sum of money equivalent to one per centum upon the entire net income, over and above $5,000, received by plaintiff from all sources during each and every of the years aforesaid, exclusive of amounts received by it as dividends upon stock of other corporations, joint stock companies or associations, or insurance companies, subject to the said tax.

And being so liable to pay the tax aforesaid, plaintiff in each and every of the years 1909, 1910, 1911 and 1912, made and delivered to the United States Collector of Internal Revenue for the Fourth collection district of Michigan, at the time and in manner and form required by law, a true and correct return of plaintiff's entire net income computed, and in said return stated and set forth, in accordance with the said statute and the rules and regulations of the Treasury Department of the United States of America in that behalf provided, which returns were in aggregate as follows:

Income (less specific deduction of $5,000) returned for 1909	$26,302.34
Income (less specific deduction of $5,000) returned for 1910	55,292.16
Income (less specific deduction of $5,000) returned for 1911	56,219.27
Income (less specific deduction of $5,000) returned for 1912	77,134.84

And thereafter the Commissioner of Internal Revenue of
3 the United States of America, in manner and form as by law

required, assessed said special excise tax against plaintiff as follows:

For the year 1909	$263.02
For the year 1910	552.92
For the year 1911	562.19
For the year 1912	771.35

which amounts so assessed plaintiff thereafter paid to the United States Collector of Internal Revenue for the Fourth collection district of Michigan, at the several and respective times when the same became due and payable, pursuant to the act of Congress aforesaid.

And plaintiff further said that, to wit, December 31, 1908, it was the owner of certain property, to wit, a large area of land in the State of Michigan, with the timber, wood, and other forest products standing and being thereon, which land and forest products thereon had been acquired by plaintiff long prior to said December 31, 1908, at a price less than its actual market value on said last named day, and plaintiff's business then was, thence hitherto hath been, and still is the lumbering of said lands, converting the trees thereon into lumber and other forest products, marketing and selling the same, and selling the remaining stump land from time to time as opportunity offered.

And plaintiff saith that on said December 31, 1908, said lands and the forest and forest products thereon were part of the capital assets of plaintiff, and were then, by reason of the large appreciation in value of timber and timber lands which had occurred prior to said December 31, 1908, worth much more than the price paid by plaintiff therefor, which price was the book value of said lands and entered on plaintiff's books of account.

And plaintiff saith that on said December 31, 1908, the actual cash market value of the trees, timber, and forest products on its lands aforesaid, was as follows, to wit:

Hemlock stumpage, $4.00 per thousand feet board measure.
Maple stumpage, $4.00 per thousand feet board measure.
Beech stumpage, $2.00 per thousand feet board measure.
Birch stumpage, $4.00 per thousand feet board measure.
Elm stumpage (both hard and soft) $8.00 per thousand feet board measure.
Ash stumpage, $8.00 per thousand feet board measure.
4 Cherry stumpage, $10.00 per thousand feet board measure.
Basswood stumpage, $8.00 per thousand feet board measure.
Oak stumpage, $10.00 per thousand feet board measure.
Pine stumpage, $20.00 per thousand feet board measure.
Cedar stumpage, $1.00 per thousand feet board measure.
Tamarack stumpage, $2.00 per thousand feet board measure.
Ironwood stumpage, $2.00 per thousand feet board measure.
Firewood, 25c per cord.
Square timber, 32c per cubic foot for elm; 40c per cubic foot for pine.

Fence posts, telephone poles, railroad ties, and shingles, being the cedar products cut by plaintiff during the years 1911 and 1912, $6,351.13.

And on said December 31, 1908, the average actual market value of the stump land, parcel of plaintiff's capital assets aforesaid, from which plaintiff had removed the timber and other forest products, and the land alone, parcel as aforesaid, from which plaintiff removed the timber and other forest products during the years 1909, 1910, 1911, and 1912, was, to wit, $10.00 per acre.

And plaintiff further saith that on, to wit, December 31, 1908, it was the owner of certain other real property in Cadillac, Michigan, known as 122 South Mitchell street, which property was then of actual market value of, to wit, $5,000, and also of certain other real property in Grand Rapids, Michigan, known as lot 164 and the west 38 feet of lot 165, in Kellogg & Bemis' Addition to said city, which was then of the actual market value of $700, all of which two last mentioned properties were on said December 31, 1908, part of plaintiff's capital assets.

And plaintiff saith that, in computing its net income as a measure of the special excise tax aforesaid, under the act of Congress aforesaid, it was entitled to deduct from its receipts the actual value of its capital assets aforesaid converted in each of said years 1909, 1910, 1911, and 1912, and that, in making its returns as aforesaid, it did deduct from its receipts the actual value of said capital assets aforesaid, at the actual market value thereof aforesaid, and that said deductions for restoration of the capital assets aforesaid in each of the years 1909, 1910, 1911, and 1912, were as follows, to wit:

For the year 1909:	
For merchantable timber stumpage cut and converted	$109,927.04
For stump land sold	8,607.11
For firewood sold	4,023.00
For the year 1910:	
For merchantable timber stumpage cut and converted	104,088.03
For stump land sold	3,284.01
For firewood	4,379.25
For sale of property 122 South Mitchell Street	1,500.00
For sale of lot 164 and the west 38 feet of lot 165 in Kellogg & Bemis' Addition to Grand Rapids, Mich	200.00
For the year 1911:	
For merchantable timber stumpage cut and converted	83,903.56
For stump lands sold	1,819.72
For firewood sold	5,454.75

For the year 1912:

For merchantable timber stumpage cut and converted	$122,097.23
For stump land sold	19,486.59
For square timber	5,957.07
For cedar posts, telephone and telegraph poles, ties, and shingles	6,351.13
For firewood	4,757.25

And plaintiff made the aforesaid payment of the special excise tax aforesaid on the basis of the returns aforesaid.

And plaintiff further saith that in the year 1913 the United States Commissioner of Internal Revenue required plaintiff to show cause why it should not be assessed additional special excise taxes under the act of Congress aforesaid for the years 1909, 1910, 1911, and 1912, as follows:

For the year 1909	$685.09
For the year 1910	553.63
For the year 1911	391.99
For the year 1912	1,101.31

for the reason that (as alleged by said Commissioner) plaintiff's capital assets cut, converted, and sold during the years aforesaid were not of the actual market value aforesaid, but of less actual market value, to wit:

6 That the merchantable timber stumpage cut and converted in the year 1909 was of the value of $54,048.06 only instead of the value of $109,927.04. That the stump lands sold in the year 1909 and the firewood sold during the year 1909 were of no value as capital assets.

That the merchantable timber stumpage cut and converted in the year 1910 was of the value of $58,038.28 only instead of $104,038.33. That the stump lands sold, the firewood sold, were of no value as capital assets, and that the property at 122 South Mitchell Street and the lots in Kellogg & Bemis Addition at Grand Rapids, Michigan, aforesaid, were of no value as capital assets in excess of the value at which they were carried on the plaintiff's books.

That for the year 1911 the merchantable timber stumpage cut and converted was of the value of only $51,979.89 instead of $83,908.56, and that the stump lands sold and the firewood sold was of no value as capital assets.

That for the year 1912 the merchantable timber stumpage cut and converted was of the value of $48,517.92 only instead of $122,097.23, and that the stump land sold, the square timber cut and converted, the cedar products, such as fence posts, telephone and telegraph poles, ties, and shingles, and the firewood sold were of no value as capital assets. That plaintiff was not entitled to have said sums reckoned as and for restoration of capital assets before computing its net income under the statute aforesaid, and that therefore there

was due the United States from plaintiff for the special excise taxes aforesaid, for the years aforesaid, the following sums, to wit:

For 1909	$685.09
For 1910	553.63
For 1911	391.99
For 1912	1,101.31

And thereupon plaintiff did show cause to said Commissioner why said additional special excise taxes for the years aforesaid should not be assessed against it, and plaintiff protested against such assessment and the said Commissioner of Internal Revenue thereupon, to wit, December 4, 1913, confirmed the addition assessment of special excise taxes aforesaid for the years aforesaid, as follows, to wit:

For the year 1909	$685.09
For the year 1910	553.63
For the year 1911	391.99
For the year 1912	1,101.31

7 and ordered the collection of the same, pursuant to the act of Congress aforesaid.

And on, to wit, December 12, 1913, the United States Collector of Internal Revenue for the Fourth Collection District of Michigan, demanded of plaintiff the payment of the additional taxes aforesaid and threatened, if the same were not paid to enforce the collection thereof with the penalties by the said act of Congress provided, in manner and form as by law provided.

And thereupon, in order to prevent the accrual of penalties and distraint of plaintiff's property, plaintiff on, to wit, December 22, 1913, paid to the said United States Collector of Internal Revenue for the Fourth Collection District of Michigan the sum of $2,732.02, being the amount of the additional special excise taxes assessed as aforesaid, under protest, which protest was and is in the words and figures following, to wit:

"DECEMBER 22, 1913.

Hon. GEO. CLAPPERTON,

Collector of Internal Revenue, Grand Rapids, Mich.

DEAR SIR: As attorneys for Mitchell Bros. Co., of Cadillac, Michigan, we herewith enclose Grand Rapids exchange in the sum of $2,732.02 in payment of additional assessments of special excise taxes under the act of Congress of August 5, 1909, as follows:

1909	$685.09
1910	553.63
1911	391.99
1912	1,101.31

We desire it understood that the payment of these taxes is made under protest; that said taxes were illegally and wrongfully assessed and collected because the character of the assets assessed as income was and is capital and not income within the meaning of the act of

August 5, 1909. In issuing receipts for the payment of these taxes kindly let the receipt show that the payment was made under this protest.

Very truly yours,

LWH/O (Signed) NORRIS, MCPHERSON & HARRINGTON."

Enc.

And thereafter on, to wit, December 22, 1913, plaintiff caused an appeal for the refunding of said sum of $2,732.02, and the several and respective items thereof, to be made to the United States Commissioner of Internal Revenue, in manner and form as provided in section 3226 of the Revised Statutes of the United States, the provisions of law in that regard and the regulations of the Secretary of the Treasury established in pursuance thereof, and thereafter and on, to wit, April 13, 1914, plaintiff's said appeal was rejected by the said Commissioner of Internal Revenue.

8

Whereby, by reason of the premises and the statutes of the United States in such case made and provided, plaintiff became, and was, entitled to demand from defendant, and defendant became, and was, liable to pay to plaintiff the said sum of $2,732.02 and interest thereon, when he, defendant, should be thereunto requested, and defendant being so liable on, to wit, April 13, 1914, promised to pay to plaintiff the said sum.

And whereas also, the plaintiff heretofore, to wit, on the 31st day of December, A. D. 1908, was, thence hitherto hath been, and still is a corporation organized and existing under the laws of the State of Michigan and was, thence hitherto hath been, and still is a citizen of the State of Michigan and a resident of Cadillac, Wexford county, in said State.

And defendant, at the time of the commencement of this action, was a citizen of said State of Michigan and a resident of Grand Rapids, in said Kent county, in said district and division of Michigan, and was Collector of Internal Revenue of the United States of America for the Fourth Collection District of Michigan.

And plaintiff saith that, being a corporation as aforesaid, it was for the year 1909 subject to and liable to pay to the United States of America the special excise tax with respect to the carrying on or doing business by plaintiff by section 38 of an act of the Congress of the United States, entitled "An act to provide revenue, equalize duties, and encourage the industries of the United States, and for other purposes," approved August 5, 1909, which tax in each of the years aforesaid was, by the act aforesaid, limited to an amount or sum of money equivalent to one per centum upon the entire net income over and above $5,000 received by plaintiff from all sources during the year aforesaid, exclusive of amounts received by it as dividends upon stock of other corporations, joint stock companies, or associations or insurance companies, subject to the said tax.

And being so liable to pay the tax aforesaid plaintiff, in the year 1909, made and delivered to the United States Collector of Internal

Revenue for the Fourth Collection District of Michigan, at the time and in manner and form required by law, a true and correct return of plaintiff's entire net income, computed and in said return stated and set forth, in accordance with the said statute and the rules and regulations of the Treasury Department of the United
9 States of of America in that behalf provided, which return was in aggregate as follows:

Income (less specific deduction of $5,000) returned for the year 1909, $26,302.34.

And thereafter the Commissioner of Internal Revenue of the United States of America, in manner and form as by law required, assessed said special excise tax against plaintiff as follows:

For the year 1909..... $263.02

which amount so assessed plaintiff thereafter paid to the United States collector of internal revenue for the fourth collection district of Michigan at the time when the same became due and payable, pursuant to the act of Congress aforesaid.

And plaintiff further saith that on, to wit, December 31, 1908, it was the owner of certain property, to wit, a large area of land in the State of Michigan, with the timber, wood, and other forest products standing and being thereon, which land and forest products thereon had been acquired by plaintiff long prior to December 31, 1908, at a price less than its actual market value on said last named day, and plaintiff's business then was, thence hitherto hath been, and still is the lumbering of said lands, converting the trees thereon into lumber and other forest products, marketing and selling the same and selling the remaining stump land from time to time as opportunity offered.

And plaintiff saith that on said December 31, 1908, said lands and the forest and the forest products thereon were part of the capital assets of plaintiff, and were then, by reason of the large appreciation in value of timber and timber lands which had occurred prior to said December 31, 1908, worth much more than the price paid by plaintiff therefor, which price was the book value of said lands as entered on plaintiff's books of account.

And plaintiff saith that on said December 31, 1908, the actual cash market value of the trees, timber, and forest products on its lands aforesaid was as follows:

Hemlock stumpage, $4.00 per thousand feet board measure.

Maple stumpage, $4.00 per thousand feet board measure.

Beech stumpage, $2.00 per thousand feet board measure.

Birch stumpage, $4.00 per thousand feet board measure.

Elm stumpage (both hard and soft) $8.00 per thousand feet board measure.

Ash stumpage, $8.00 per thousand feet board measure.

10 Cherry stumpage, $10.00 per thousand feet board measure.

Basswood stumpage, $8.00 per thousand feet board measure.

Oak stumpage, $10.00 per thousand feet board measure.

Pine stumpage, $20.00 per thousand feet board measure.
Ironwood stumpage, $2.00 per thousand feet board measure.
Firewood, 25c per cord.

And on said December 31, 1908, the average actual market value of the stump land parcel of plaintiff's capital assets aforesaid, from which plaintiff had removed the timber and other forest products, and the land alone, parcel as aforesaid, from which plaintiff removed the timber and other forest products during the year 1909, was, to wit, $10.00 per acre.

And plaintiff saith that in computing its net income as a measure of the special excise tax aforesaid, under the act of Congress aforesaid, it was entitled to deduct from its receipts the actual value of its capital assets aforesaid converted in the year 1909, and that in making its returns as aforesaid it did deduct from its receipts the actual value of said capital assets aforesaid at the actual market value thereof aforesaid, and that said deductions for restorations of the capital assets aforesaid in the year 1909 were as follows, to wit:

For merchantable timber stumpage cut and converted	$109,927.04
For stump lands sold	8,607.11
For firewood sold	4,023.00

And plaintiff made the aforesaid payment of the special excise tax aforesaid on the basis of the return aforesaid.

And plaintiff further saith that in the year 1913 the United States Commissioner of Internal Revenue required plaintiff to show cause why it should not be assessed additional special excise tax under the act of Congress aforesaid for the year 1909 in the sum of $685.09, for the reason that (as alleged by said commissioner) plaintiff's capital assets cut, converted, and sold during the year aforesaid were not of the actual market value aforesaid, but were of less actual market value, to wit, that the merchantable timber stumpage cut and converted in the year 1909 was of the value of $54,048.06 instead of the value of $109,927.04; that the stump lands sold in the year 1909 and the firewood sold during the year 1909 were of no value
11 as capital assets; that the plaintiff was not entitled to have said sums refunded as and for restoration of capital assets before computing its net income under the statute aforesaid, and that, therefore, there was due the United States from plaintiff for the special excise tax aforesaid for the year 1909 to sum of, to wit, $685.09.

And thereupon plaintiff did show cause to said commissioner why said additional special excise tax for the year aforesaid should not be assessed against it, and plaintiff protested against such assessment, and the said Commissioner of Internal Revenue thereupon on, to wit, December 4, 1913, confirmed the additional assessment of special excise tax aforesaid for the year 1909 as follows, to wit: at the sum of $685.09, and ordered the collection of the same pursuant to the act of Congress aforesaid.

And on, to wit, December 12, 1913, the United States collector of internal revenue for the fourth collection district of Michigan demanded of plaintiff the payment of the additional taxes aforesaid, and threatened if the same were not paid to enforce the collection thereof with the penalties by the said act of Congress provided, in manner and form as by law provided.

And thereupon, in order to prevent the accrual of penalties and distraint of plaintiff's property, plaintiff on, to wit, December 22, 1913, paid to the United States collector of internal revenue of the fourth collection district of Michigan the sum of $685.09, being the amount of the additional special excise tax for the year 1909 assessed as aforesaid, under protest, which protest was and is in the words and figures following, to wit:

"DECEMBER 22, 1913.

Hon. GEO. CLAPPERTON,
Collector of Internal Revenue, Grand Rapids, Mich.

DEAR SIR: As attorneys for Mitchell Bros. Co. of Cadillac, Michigan, we herewith enclose Grand Rapids exchange in the sum of $2,732.02 in payment of additional assessments of special excise taxes under the act of Congress of August 5, 1909, as follows:

1909	$685.09
1910	553.63
1911	391.99
1912	1,101.31

We desire it understood that the payment of these taxes is made under protest, that said taxes were illegally and wrongfully assessed and collected because the character of the assets assessed as income was and is capital and not income within the meaning of the act of August 5, 1909. In issuing receipts for the payment of
12 these taxes, kindly let the receipt show that the payment was made under this protest.

Very truly, yours,

LWH/O (Signed) NORRIS, MCPHERSON & HARRINGTON."
Enc.

And thereafter, to wit, December 22, 1913, plaintiff caused an appeal for the refunding of the said sum of $685.09 to be made to the United States Commissioner of Internal Revenue, in manner and form as provided in section 3226 of the Revised Statutes of the United States, the provisions of law in that regard and the regulations of the Secretary of the Treasury established in pursuance thereof, and thereafter, and on, to wit, April 13, 1914, plaintiff's said appeal was rejected by the said Commissioner of Internal Revenue.

Whereby, by reason of the premises and of the statutes of the United States in such case made and provided, plaintiff became and was entitled to demand from defendant, and defendant became and was liable to pay to plaintiff the said sum of $685.09 and interest thereon, when he, defendant, should be thereunto requested, and de-

fendant being so liable on, to wit, April 13, 1914, promised to pay to plaintiff the said sum.

And whereas, also, the plaintiff heretofore, to wit, on the 31st day of December, A. D. 1908, was, thence hitherto hath been, and still is, a corporation organized and existing under the laws of the State of Michigan, and was, thence hitherto hath been, and still is, a citizen of the State of Michigan and a resident of Cadillac, Wexford County, in said State.

And defendant, at the time of the commencement of this action, was a citizen of said State of Michigan, and a resident of Grand Rapids, in Kent County, in said district and division of Michigan, and was collector of internal revenue of the United States of America for the fourth collection district of Michigan.

And plaintiff saith that, being a corporation as aforesaid, it was for the year 1910 subject to and liable to pay to the United States of America the special excise tax with respect to the carrying on or doing business by plaintiff imposed on plaintiff by section 38 of an act of the Congress of the United States entitled, "An act to provide revenue, equalize duties and encourage the industries of the United States, and for other purposes," approved August 5, 1909, which tax in each of the years aforesaid was, by the act aforesaid, limited to an amount or sum of money equivalent to one per centum upon the entire net income over and above $5,000 received by plaintiff from all
13 sources during the year aforesaid, exclusive of amounts received by it as dividends upon stock of other corporations, joint stock companies or associations, or insurance companies, subject to the said tax.

And being so liable to pay the tax aforesaid, plaintiff in the year 1910 made and delivered to the United States collector of internal revenue for the fourth collection district of Michigan, at the time and in manner and form required by law, a true and correct return of plaintiff's entire net income computed, and in said return stated and set forth, in accordance with the said statute and the rules and regulations of the Treasury Department of the United States of America in that behalf provided, which return was in aggregate as follows:

Income (less specific deduction of $5,000) return for the year 1910, $55,292.16.

And thereafter the Commissioner of Internal Revenue of the United States of America, in manner and form as by law required, assessed said special excise tax against plaintiff as follows:

For the year 1910 ..... $552.92

which amount so assessed plaintiff thereafter paid to the United States collector of internal revenue for the fourth collection district of Michigan at the time when the same became due and payable, pursuant to the act of Congress aforesaid.

And plaintiff further saith that on, to wit, December 31, 1908, it was the owner of certain property, to wit, a large area of land in the

State of Michigan, with the timber, wood, and other forest products standing and being thereon, which land and forest products had been acquired by plaintiff long prior to December 31, 1908, at a price less than its actual market value on said last named day, and plaintiff's business then was, thence hitherto hath been, and still is the lumbering of said land, converting the trees thereon into lumber and other forest products, marketing and selling the same, and selling the remaining stump land from time to time as opportunity offered.

And plaintiff saith that on said December 31, 1908, said lands and the forest products thereon were part of the capital assets of plaintiff and were then, by reason of the large appreciation in value of timber and timber lands which had occurred prior to said December 31, 1908, worth much more than the price paid by plaintiff therefor, which price was the book value of said lands as entered on plaintiff's books of account.

14 And plaintiff saith that on said December 31, 1908, the actual cash market value of the trees, timber, and forest products on its lands aforesaid was as follows:

Hemlock stumpage, $4.00 per thousand feet, board measure.
Maple stumpage, $4.00 per thousand feet, board measure.
Beech stumpage, $2.00 per thousand feet, board measure.
Birch stumpage, $4.00 per thousand feet, board measure.
Elm stumpage (both hard and soft), $8.00 per thousand feet, board measure.
Ash stumpage, $8.00 per thousand feet, board measure.
Cherry stumpage, $10.00 per thousand feet, board measure.
Basswood stumpage, $8.00 per thousand feet, board measure.
Oak stumpage, $10.00 per thousand feet, board measure.
Pine stumpage, $20.00 per thousand feet, board measure.
Ironwood stumpage, $2.00 per thousand feet, board measure.
Cedar stumpage, $1.00 per thousand feet, board measure.
Tamarack stumpage, $2.00 per thousand feet, board measure.
Firewood, 25 cents per cord.

And on December 31, 1908, the average actual market value of the stump land, parcel of plaintiff's capital assets aforesaid, from which plaintiff had removed the timber and other forest products, and the land alone, parcel as aforesaid, from which plaintiff removed the timber and other forest products during the year 1910 was, to wit, $10.00 per acre.

And plaintiff further saith that on, to wit, December 31, 1908, it was the owner of certain other real property in Cadillac, Michigan, known as 122 South Mitchell Street, which property was then of actual market value of, to wit, $5,000; and also of certain other real property in Grand Rapids, Michigan, known as lot 164 and the west 33 feet of lot 165 in Kellogg & Bemis' Addition to said city, which was then of the actual market value of $700.00, all of which two last mentioned properties were on said December 31, 1908, part of plaintiff's capital assets.

And plaintiff saith that in computing its net income as a measure of the special excise tax aforesaid, under the act of Congress aforesaid, it was entitled to deduct from its receipts the actual value of its capital assets aforesaid converted in the year 1910, and that in making its returns as aforesaid it did deduct from its receipts the actual value of said capital assets aforesaid, at the actual market value thereof aforesaid, and that said deductions for restoration of the capital assets aforesaid in the year 1910 were as follows, to wit:

For merchantable timber stumpage cut and converted	$104,038.08
For stump lands sold	3,284.01
For firewood sold	4,379.25
For sale of property 122 South Mitchell Street	1,500.00
For sale of lot 164 and west 38 feet of lot 165 in Kellogg & Bemis's addition to Grand Rapids, Michigan	200.00

And plaintiff made the aforesaid payment of the special excise tax aforesaid on the basis of the return aforesaid.

And plaintiff further saith that in the year 1913 the United States Commissioner of Internal Revenue required plaintiff to show cause why it should not be assessed additional special excise tax under the act of Congress aforesaid for the year 1910 in the sum of $553.63, for the reason that (as alleged by said commissioner) plaintiff's capital assets cut, converted, and sold during the year aforesaid were not of the actual market value aforesaid, but were of less actual market value, to wit: That the merchantable timber stumpage cut and converted in the year 1910 was of the value of $58,038.28, instead of $104,038.33; that the stump lands sold and the firewood sold were of no value as capital assets, and that the property at 122 South Mitchell Street and the lots in Kellogg & Bemis's Addition at Grand Rapids, Michigan, aforesaid, were of no value as capital assets in excess of the value at which they were carried on plaintiff's books; that the plaintiff was not entitled to have said sums refunded as and for restoration of capital assets before computing its net income under the statute aforesaid, and that, therefore, there was due the United States from plaintiff for the special excise tax aforesaid for the year 1910 the sum of, to wit, $553.63.

And thereupon plaintiff did show cause to said commissioner why said additional special excise tax for the year aforesaid should not be assessed against it, and plaintiff protested against such assessment, and the said Commissioner of Internal Revenue thereupon, on to wit, December 12, 1913, confirmed the additional assessment of special excise tax aforesaid for the year 1910, as follows, to wit, at the sum of $553.63, and ordered the collection of the same pursuant to the act of Congress aforesaid.

And on, to wit, December 12, 1913, the United States collector of internal revenue for the fourth collection district of Michigan demanded of plaintiff the payment of the additional taxes aforesaid, and threatened, if the same were not paid, to enforce the col-

lection thereof, with the penalties by the said act of Congress provided, in manner and form as by law provided.

And thereupon, in order to prevent the accrual of penalties and distraint of plaintiff's property, plaintiff on, to wit, December 22, 1913, paid to the United States collector of internal revenue for the fourth collection district of Michigan, the sum of $553.63, being the amount of the additional special excise tax for the year 1910 assessed, as aforesaid, under protest, which protest was and is in the words and figures following, to wit:

"DECEMBER 22, 1913.

Hon. GEO. CLAPPERTON,

Collector of Internal Revenue, Grand Rapids, Mich.

DEAR SIR: As attorneys for Mitchell Bros. Co. of Cadillac, Michigan, we herewith enclose Grand Rapids exchange in the sum of $2,732.02 in payment of additional assessments of special excise taxes under the act of Congress of August 5, 1909, as follows:

1909	$685.09
1910	553.63
1911	391.99
1912	1,191.31

We desire it understood that the payment of these taxes is made under protest; that said taxes were illegally and wrongfully assessed and collected because the character of the assets assessed as income was and is capital and not income within the meaning of the act of August 5, 1909. In issuing receipts for the payment of these taxes, kindly let the receipt show that the payment was made under this protest.

SWH/O Very truly, yours,
Enc. (Signed) NORRIS, MCPHERSON & HARRINGTON."

And thereafter on, to wit, December 22, 1913, plaintiff caused an appeal for the refunding of the said sum of $553.63, to be made to the United States Commissioner of Internal Revenue, in manner and form as provided in section 3226 of the Revised Statutes of the United States, the provisions of law in that regard, and the regulations of the Secretary of the Treasury established in pursuance thereof, and thereafter and on, to wit, April 18, 1914, plaintiff's said
17 appeal was rejected by the said Commissioner of Internal Revenue.

Whereby, by reason of the premises and of the statutes of the United States in such case made and provided, plaintiff became and was entitled to remand from defendant, and defendant became and was liable to pay to plaintiff the said sum of $553.63 and interest thereon when he, defendant, should be thereunto requested, and defendant being so liable on, to wit, April 18, 1914, promised to pay the plaintiff the said sum.

And whereas, also, the plaintiff heretofore, to wit, on the twenty-first day of December, A. D. 1906, was, thence hitherto hath been, and still is, a corporation organized and existing under the laws of the

State of Michigan, and was, thence hitherto hath been, and still is, a citizen of the State of Michigan and a resident of Cadillac, Wexford County, in said State.

And defendant, at the time of the commencement of this action, was a citizen of said State of Michigan and a resident of Grand Rapids, in Kent County, in said district and division of Michgan, and was Collector of Internal Revenue of the United States of America for the Fourth Collection District of Michigan.

And plaintiff saith that, being a corporation as aforesaid, it was, for the year 1911, subject to and liable to pay to the United States of America the special excise tax with respect to the carrying on or doing business by plaintiff, imposed on plaintiff by section 38 of an act of the Congress of the United States entitled, "An act to provide reveune, equalize duties, and encourage the industries of the United States, and for other purposes," approved August 5, 1909, which tax, in each of the years aforesaid was, by the act aforesaid, limited to an amount or sum of money equivalent to one per centum upon the entire net income over and above $5,000 received by plaintiff from all source during the year aforesaid, exclusive of amounts received by it as dividends upon stock of other corporations, joint stock companies or associations, or insurance companies, subject to the said tax.

And being so liable to pay the tax aforesaid plaintiff, in the year 1911, made and delivered to the United States Collector of Internal Revenue for the Fourth Collection District of Michigan, at the time and in the manner and form required by law, a true and correct return of plaintiff's entire net income computed and in said return stated and set forth, in accordance with the said statue and the rules and regulations of the Treasury Department of the United States of America in that behalf provided, which return was, in the aggregate, as follows:

18 Income (less specific deduction of $5,000) return for the year 1911, $56,219.27.

And thereafter the Commissioner of Internal Revenue of the United States of America, in manner and form as by law required, assessed said special excise tax against plaintiff as follows:

For the year 1911..... $562.19,

which amount so assessed plaintiff thereafter paid to the United States Collector of Internal Revenue for the Fourth Collection District of Michigan at the time when the same became due and payable, pursuant to the act of Congress aforesaid.

And plaintiff further saith that on, to wit, December 31, 1908, it was the owner of certain property, to wit, a large area of land in the State of Michigan, with the timber, wood, and other forest products standing and being thereon, which land and forest products thereon had been acquired by plaintiff long prior to December 31, 1908, at a price less than its actual market value on said last-named day, and plaintiff's business then was, thence hitherto hath been, and still is, the lumbering of said lands, converting the trees thereon into

lumber and other forest products, marketing and selling the same, and selling the remaining stump land, from time to time, as opportunity offered.

And plaintiff saith that on said December 31, 1908, said lands and the forest and the forest products thereon were part of the capital assest of plaintiff, and were then, by reason of the large appreciation in value of timber and timber lands which had occurred prior to said December 31, 1908, worth much more than the price paid by plaintiff therefor, which price was the book value of said lands as entered on plaintiff's books of account.

And plaintiff saith that on said December 31, 1908, the actual cash market value of the trees, timber, and forest products on its lands aforesaid was as follows:

Hemlock stumpage, $4.00 per thousand feet board measure.
Maple stumpage, $4.00 per thousand feet board measure.
Beech stumpage, $2.00 per thousand feet board measure.
Birch stumpage, $4.00 per thousand feet board measure.
Elm stumpage (both hard and soft), $8.00 per thousand feet board measure.
Ash stumpage, $8.00 per thousand feet board measure.
Cherry stumpage, $10.00 per thousand feet board measure.
Basswood stumpage, $8.00 per thousand feet board measure.
Oak stumpage, $10.00 per thousand feet board measure.
Pine stumpage, $20.00 per thousand feet board measure.
Cedar stumpage, $1.00 per thousand feet board measure.
Tamarack stumpage, $2.00 per thousand feet board measure.
Firewood, $0.25 per cord.

And on December 31, 1908, the average market value of the stump land, parcel of plaintiff's capital assets aforesaid, from which plaintiff had removed the timber and other forest products, and the land alone, parcel as aforesaid, from which plaintiff removed the timber and other forest products during the year 1911, was, to wit, $12.00 per acre.

And plaintiff saith that in computing its net income as a measure of the special excise tax aforesaid, under the act of Congress aforesaid, it was entitled to deduct from its receipts the actual value of its capital assets aforesaid converted in the year 1911, and that in making its returns as aforesaid it did deduct from its receipts the actual value of said capital assets aforesaid, at the actual market value thereof aforesaid, and that said deductions for restoration of the capital assets aforesaid, in the year 1911, were as follows, to wit, for merchantable timber stumpage cut and converted..... $83,903.56
For stump lands sold..... 1,819.72
For fire wood sold..... 5,454.75

And plaintiff made the aforesaid payment of the special excise tax aforesaid on the basis of the return aforesaid.

And plaintiff further saith that in the year 1913 the United States Commissioner of Internal Revenue required plaintiff to show cause

why it should not be assessed additional special excise tax under the act of Congress aforesaid for the year 1911 in the sum of $391.99, for the reason that (as alleged by said commissioner) plaintiff's capital assets cut, converted, and sold during the year aforesaid were not of the actual market value aforesaid, but were of less actual market value, to wit, that the merchantable timber stumpage cut and converted in the year 1911 was of the value of $51,979.39, instead of $83,903.56, and that the stump lands sold and the firewood sold were of no value as capital assets; that the plaintiff was not entitled to have said sums refunded as and for restoration of capital assets before computing its net income under the statute aforesaid, and that therefore there was due the United States from plaintiff for the special excise tax aforesaid for the year 1911 the sum of, to wit, $391.99.

And thereupon plaintiff did show cause to said commissioner why said additional special excise tax for the year aforesaid should not be assessed against it, and plaintiff protested against such assessment, and the said Commissioner of Internal Revenue thereupon on, to wit, December 12, 1913, confirmed the additional assessment of special excise tax aforesaid for the year 1911 as follows, to wit, at the sum of $391.99, and ordered the collection of the same pursuant to the act of Congress aforesaid.

And on, to wit, December 12, 1913, the United States Collector of Internal Revenue for the fourth collection district of Michigan demanded of plaintiff the payment of the additional taxes aforesaid, and threatened, if the same were not paid, to enforce the collection thereof with the penalties by the said act of Congress provided, in manner and form as by law provided.

And thereupon, in order to prevent the accrual of penalties and distraint of plaintiff's property, plaintiff on, to wit, December 22, 1913, paid to the United States Collector of Internal Revenue for the fourth collection district of Michigan the sum of $391.99, being the amount of the additional special excise tax for the year 1911 assessed as aforesaid, under protest, which protest was and is in the words and figures following, to wit:

DECEMBER 22, 1913.

Hon. GEO. CLAPPERTON, *Collector of Internal Revenue, Grand Rapids, Mich.:*

DEAR SIR: As attorneys for Mitchell Bros Co. of Cadillac, Michigan, we herewith enclose Grand Rapids exchange in the sum of $2,782.02 in payment of additional assessments of special excise taxes under the act of Congress of August 5, 1909, as follows:

1909	$385.09
1910	553.63
1911	391.99
1912	1,101.31

We desire it understood that the payment of these taxes is made under protest; that said taxes were illegally and wrongfully assessed and collected because the character of the assets assessed as income

was and is capital and not income within the meaning of the act of August 5, 1909. In issuing receipts for the payment of
21 these taxes, kindly let the receipt show that the payment was made under this protest.

LWH/O. Very truly, yours,
Enc. (Signed) NORRIS, MCPHERSON & HARRINGTON."

And thereafter on, to wit, December 22, 1913, plaintiff caused an appeal for the refunding of the said sum of $391.99 to be made to the United States Commissioner of Internal Revenue, in manner and form as provided in section 3226 of the Revised Statutes of the United States, the provision of law in that regard and the regulations of the Secretary of the Treasury established in pursuance thereof, and thereafter, and on, to wit, April 13, 1914, plaintiff's said appeal was rejected by the said Commissioner of Internal Revenue.

Thereby, by reason of the premises and of the statutes of the United States in such case made and provided, plaintiff became and was entitled to demand from defendant, and defendant became and was liable to pay to plaintiff, the said sum of $391.99 and interest thereon when he, defendant, should be thereunto requested, and defendant being so liable on, to wit, April 13, 1914, promised to pay to plaintiff the said sum.

And whereas, also the plaintiff heretofore, to wit, on the thirty-first day of December, 1908, was, thence hitherto hath been, and still is a corporation organized and existing under the laws of the State of Michigan, and was, thence hitherto hath been, and still is a citizen of the State of Michigan and a resident of Cadillac, Wexford county, in said State.

And defendant, at the time of the commencement of this action, was a citizen of said State of Michigan and a resident of Grand Rapids, in said Kent County, in said district and division of Michigan, and was collector of internal revenue of the United States of America for the fourth collection district of Michigan.

And plaintiff saith that, being a corporation as aforesaid, it was, for the year 1912, subject to and liable to pay to the United States of America the special excise tax with respect to the carrying on or doing business by plaintiff imposed on plaintiff by section 38 of an act of the Congress of the United States, entitled "An act to provide revenue, equalize duties, and encourage the industries of the United States, and for other purposes," approved August 5, 1909, which tax, in each of the years aforesaid, was, by the act aforesaid, limited to an amount or sum of money equivalent to one per centum upon the entire net income over and above $5,000 received by plaintiff
22 from all sources during the year aforesaid, exclusive of amounts received by it as dividends upon stock of other corporations, joint stock companies, or associations or insurance companies subject to the said tax.

And being so liable to pay the tax aforesaid, plaintiff, in the year 1912, made and delivered to the United States collector of internal

revenue for the fourth collection district of Michigan, at the time and in manner and form required by law, a true and correct return of plaintiff's entire net income computed and in said return stated and set forth, in accordance with the said statute and the rules and regulations of the Treasury Department of the United States of America in that behalf provided, which return was in aggregate as follows:

Income (less specific deduction of $5,000) return for the year 1912, $77,134.84.

And thereafter the Commissioner of Internal Revenue of the United States of America, in manner and form as by law required, assessed said special excise tax against plaintiff as follows:

For the year 1912..... $771.35

Which amount so assessed plaintiff thereafter paid to the United States collector of internal revenue for the fourth collection district of Michigan, at the time when the same became due and payable, pursuant to the act of Congress aforesaid.

And plaintiff further saith that on, to wit, December 31, 1908, it was the owner of certain property, to wit, a large area of land in the State of Michigan, with the timber, wood, and other forest products standing and being thereon, which land and forest products thereon had been acquired by plaintiff long prior to December 31, 1908, at a price less than its actual market value on said last named day, and plaintiff's business then was, thence hitherto hath been, and still is the lumbering of said lands, converting the trees thereon into lumber and other forest products, marketing and selling the same, and selling the remaining stump land, from time to time, as opportunity offered.

And plaintiff saith that on said December 31, 1908, said lands and the forest and the forest products thereon were part of the capital assets of plaintiff, and were then, by reason of the large appreciation in value of timber and timber lands which had occurred prior to said December 31, 1908, worth much more than the price paid by plaintiff therefore, which price was the book value of said lands as entered on plaintiff's books of account.

And plaintiff saith that on said December 31, 1908, the actual
23 cash market value of the trees, timber, and forest products on its lands aforesaid was as follows:

Hemlock stumpage, $4.00 per thousand feet, board measure.
Maple stumpage, $4.00 per thousand feet, board measure.
Beech stumpage, $2.00 per thousand feet, board measure.
Birch stumpage, $4.00 per thousand feet, board measure.
Elm stumpage (both hard and soft), $8.00 per thousand feet, board measure.
Ash stumpage, $8.00 per thousand feet, board measure.
Cherry stumpage, $10.00 per thousand feet, board measure.
Cedar stumpage, $1.00 per thousand feet, board measure.
Basswood stumpage, $8.00 per thousand feet, board measure.
Oak stumpage, $10.00 per thousand feet, board measure.

Pine stumpage, $20.00 per thousand feet, board measure.
Tamarack stumpage, $2.00 per thousand feet, board measure.
Firewood, 25c per cord.

And on said December 31, 1908, the average actual market value of the stump land, parcel of plaintiff's capital assets aforesaid, from which plaintiff had removed the timber and other forest products, and the land alone, parcel as aforesaid, from which plaintiff removed the timber and other forest products during the year 1911 was, to wit, $12.00 per acre.

And plaintiff saith that in computing its net income as a measure of the special excise tax aforesaid, under the act of Congress aforesaid, it was entitled to deduct from its receipts the actual value of its capital assets aforesaid converted in the year 1912 and that, in making its returns as aforesaid it did deduct from its receipts the actual value of said capital assets aforesaid at the actual market value aforesaid and that said deductions for restorations of the capital assets aforesaid in the year 1912 were as follows, to wit:

For merchantable timber stumpage cut and converted	$122,097.23
For stump lands sold	19,486.59
For square timber	5,957.07
For cedar posts, telephone and telegraph poles, ties, and shingles	6,351.18
For firewood sold	4,757.25

and plaintiff made the aforesaid payment of the special excise tax aforesaid on the basis of the return aforesaid.

And plaintiff further saith that in the year 1913 the United States Commissioner of Internal Revenue required plaintiff to show cause why it should not be assessed additional special excise tax under the act of Congress aforesaid for the year 1912 in the sum of $1,101.13, for the reason that (as alleged by said commissioner) plaintiff's capital assets cut, converted, and sold during the year aforesaid were not of the actual market value aforesaid, but were of less actual market value, to wit, that the merchantable timber stumpage cut and converted in the year 1912 was of the value of $48,517.92 only instead of $122,097.23, and that the stump lands sold, the square timber cut and converted, the cedar products, such as fence posts, telephone and telegraph poles, ties, and shingles, and the firewood sold, were of no value as capital assets; that plaintiff was not entitled to have said sums refunded as and for restoration of capital assets before computing its net income under the statute aforesaid and that, therefore, there was due the United States from plaintiff for the special excise tax aforesaid for the year 1912 the sum of, to wit, $1,101.31.

And thereupon plaintiff did show cause to said commissioner why said additional special excise tax for the year aforesaid should not be assessed against it and plaintiff protested against such assessment, and the said Commissioner of Internal Revenue thereupon on, to wit, December 12, 1913, confirmed the additional assessment of special

excise tax aforesaid for the year 1912 as follows, to wit, at the sum of $1,101.31 and ordered the collection of the same pursuant to the act of Congress aforesaid.

And on, to wit, December 12, 1913, the United States collector of internal revenue for the fourth collection district of Michigan demanded of plaintiff the payment of the additional taxes aforesaid and threatened if the same were not paid to enforce the collection thereof with the penalties by the said act of Congress provided, in manner and form as by law provided.

And thereupon, in order to prevent the accrual of penalties and distraint of plaintiff's property, plaintiff on, to wit, December 22, 1913, paid to the United States collector of internal revenue for the fourth collection district of Michigan the sum of $1,101.31, being the amount of the additional special excise tax for the year
25 1912 assessed as aforesaid under protest, which protest was and is in the words and figures following, to wit:

"DECEMBER 22, 1913.

Hon. GEORGE CLAPPERTON,
Collector of Internal Revenue, Grand Rapids, Mich.

DEAR SIR: As attorneys for Mitchell Bros. Co. of Cadillac, Michigan, we herewith enclose Grand Rapids exchange in the sum of $2,732.02 in payment of additional assessments of special excise taxes under the act of Congress of August 5, 1909, as follows:

1909	$685.09
1910	553.63
1911	391.99
1912	1,101.31

We desire it understood that the payment of these taxes is made under protest; that said taxes were illegally and wrongfully assessed and collected because the character of the assets assessed as income was and is capital and not income within the meaning of the act of August 5, 1909. In issuing receipts for the payment of these taxes kindly let the receipt show that the payment was made under this protest.

Very truly, yours,
(Signed) NORRIS, MCPHERSON & HARRINGTON."

LWH/O.
Enc.

And thereafter on, to wit, December 22, 1913, plaintiff caused an appeal for the refunding of the said sum of $1,101.31 to be made to the United States Commissioner of Internal Revenue, in manner and form as provided in section 3226 of the Revised Statutes of the United States, thet provisions of law in that regard, and the regulations of the Secretary of the Treasury established in pursuance thereof, and thereafter and on, to wit, April 13, 1914, plaintiff's said appeal was rejected by the said Commissioner of Internal Revenue.

Whereby, by reason of the premises and of the statutes of the United States in such case made and provided, plaintiff became and

was entitled to demand from defendant, and defendant became and was liable to pay to plaintiff the said sum of $1,101.31 and interest thereon when he, defendant, should be thereunto requested, and defendant being so liable on, to wit, April 13, 1914, promised to pay to plaintiff the said sum.

And whereas, also, the said defendant on, to wit, the thirteenth day of April, A. D. 1914, at, to wit, the city of Cadillac, in said district and division, was indebted to the said plaintiff in the further sum of $2,732.02, lawful money of the United States of America, for so much money before that time had and received by the said defendant
20 to and for the use of the said plaintiff, and being so indebted, the said defendant, in consideration thereof, afterwards, to wit, on the same day and year last aforesaid, and at the place aforesaid, undertook and then and there faithfully promised the said plaintiff well and truly to pay unto the said plaintiff the said sum of money last above mentioned when the said defendant should be thereunto afterwards requested.

Nevertheless, the said defendant (although often afterwards requested so to do) hath not as yet paid the said several sums of money above mentioned, or any or either of them, or any part thereof, to the said plaintiff, but to pay the same or any part thereof to the said plaintiff the said defendant hath hitherto altogether refused, and still doth refuse, to the damage of the said plaintiff, $10,000, and, therefore, the said plaintiff brings suit, etc.

NORRIS, MCPHERSON, HARRINGTON & WARE,
Attorneys for Plaintiff.

Business address: 721–730 Michigan Trust Co., Bldg., Grand Rapids, Michigan.

To the said defendant:

Take notice, that the following is a bill of particulars of the plaintiff's claim under the foregoing declaration and count for money had and received:

For one per cent on $55,878.96 value of stumpage capital assets claimed by the Commissioner of Internal Revenue to be income for 1909	$558.79
For one per cent on $8,607.11 value of stump land capital assets claimed by the Commissioner of Internal Revenue to be income for 1909	86.07
For one per cent on $4,023 value of firewood capital assets claimed by the Commissioner of Internal Revenue to be income for 1909	40.23
Total for 1909	$685.09
For one per cent on $46,000 and five cents value of stumpage capital assets claimed by the Commissioner of Internal Revenue to be income for 1910	$460.00
For one per cent on $3,284.01 value of stump land capital assets claimed by the Commissioner of Internal Revenue to be income for 1910	32.84

27	For one per cent on $4,279.25 value of firewood capital assets claimed by the Commissioner of Internal Revenue to be income for 1910	$42.79
	For one per cent on $1,500 value of realty at 122 South Mitchell St., Cadillac, Michigan, excess over the value at which said property was carried on plaintiff's books, claimed by the Commissioner of Internal Revenue to be income for 1910	15.00
	For one per cent on $200 value of lots in Kellogg & Bemis' Addition at Grand Rapids, Mich., in excess of the value at which they were carried on plaintiff's books, claimed by the Commissioner of Internal Revenue to be income for 1910	2.00
	Total for 1910	55.63
	For one per cent of $21,994.17 value of stumpage capital assets claimed by the Commissioner of Internal Revenue to be income for 1911	219.94
	For one per cent on $1,319.72 value of stump land capital assets claimed by the Commissioner of Internal Revenue to be income for 1911	13.20
	For one per cent on $5,454.75 value of firewood capital assets claimed by the Commissioner of Internal Revenue to be income for 1911	54.55
	Total for 1911	$291.99
	For one per cent on $73,579.31 value of stumpage capital assets claimed by the Commissioner of Internal Revenue to be income for 1912	$735.79
	For one per cent on $19,486.59 value of stump land capital assets claimed by the Commissioner of Internal Revenue to be income for 1912	194.87
	For one per cent on $4,757.26 value of firewood capital assets claimed by the Commissioner of Internal Revenue to be income for 1912	47.57
	For one per cent on $5,955.07 value of square timber capital assets claimed by the Commissioner of Internal Revenue to be income for 1912	59.57
28	For one per cent on $6,851.13 value of cedar products, such as ties, fence posts, telephone and telegraph poles, and shingles, capital assets claimed by the Commissioner of Internal Revenue to be income for 1912	68.51
	Total for 1912	$1,101.31

And interest thereon from December 22, 1913.

NORRIS, MCPHERSON, HARRINGTON & WARE,
Attorneys for Plaintiff.

Plea.—Filed October 28, 1914.

And now comes said defendant, Emanuel J. Doyle, as United States collector of internal revenue for the fourth collection district of Michigan, by Myron H. Walker, United States attorney, and demands a trial of the matters set forth in the plaintiff's declaration filed herein. Dated Grand Rapids, Mich., Oct. 28, 1914.

MYRON H. WALKER,
United States Attorney.

Business address: Federal Bldg., Grand Rapids, Mich.

Opinion of court.—Filed April 30, 1915.

Plaintiff was incorporated in 1903, succeeding to and taking over the property of the former copartnership, Mitchell Brothers.
29 The property purchased and so taken over by the corporation consisted, for the most part, of timber, lands, and a large sawmill plant. Since its organization plaintiff has been engaged in the lumber business, cutting and manufacturing its own timber into lumber and other forest products and selling and marketing the same. In 1903 the average market value of its merchantable hardwood timber was $2.25 per thousand feet, or its pine timber $8.00 per thousand feet, and of cut-over or "stump" lands, $2.00 per acre. Timber suitable only for cord wood had no market value. Plaintiff then paid the amounts above stated for its timber and lands and has since carried them upon its books at the same prices. The plaintiff also purchased from Mitchell Brothers an office building and lot in the city of Cadillac for $3,500.00, and two vacant lots in the city of Grand Rapids for $500.00. The prices so paid were, at that time, the fair market values of these parcels of land.

After its purchase, plaintiff's timber, lands and other property, from natural and other causes, steadily increased in value. During the years 1909, 1910, 1911 and 1912, the average and actual market value of its standing merchantable hard wood timber was from $4.00 to $4.50 per thousand feet, and of its pine $20.00 per thousand feet. The actual market value of its stump lands varied from $4.00 to $12.00 per acre.

The office building and lot in the city of Cadillac was fairly worth $5,000.00, and the two lots in the city of Grand Rapids more than $700.00. In 1906 a chemical and charcoal plant was located in the city of Cadillac and thereafter timber suitable for cord wood had a market value of twenty-five cents per cord.

In compliance with the provisions of the corporation tax act of 1909 (36 Statutes at Large, 112 Chap. 6, § 38), plaintiff made a return in each of the years 1909, 1910, 1911 and 1912. In computing its taxable net income in each of such returns, plaintiff deducted from its gross receipts the then actual market value of the timber stumpage cut and converted into lumber during that year and also the actual market value of its stump and other lands sold during the

year. An assessment was duly made by the Commissioner of Internal Revenue upon each of such returns and the excise taxes so levied were paid by the plaintiff. Afterwards and following an investigation, the Commissioner of Internal Revenue made an additional assessment for each of the four years based upon the difference between the prices paid by the plaintiff in 1908 for its timber, lands and other property as shown by and carried on its books, and the amounts deducted as and for the actual market values of such properties at the time of the making of the returns. The additional excise taxes so levied were paid by plaintiff under protest and this suit is brought to recover back the amounts so paid.

The issues here presented, although novel, are sharply defined. The plaintiff claims that its standing timber and other property were capital assets and that the portion of the proceeds derived from the cutting, manufacture and sale of such timber, measured by the actual stumpage value thereof, did not constitute income and, therefore, that, in computing its taxable net income, it was entitled to deduct such actual stumpage value of its timber from its gross receipts. The Commissioner of Internal Revenue concedes the right of the plaintiff to deduct the original cost price of the timber, as shown by its books, from its gross receipts, but denies its right to make any deduction on account of increase in values. The Attorney General contends that all the proceeds derived from the manufacture and sale of the timber constituted income and that plaintiff, in its returns of taxable net income, had no right to make any deductions whatsoever on account of either cost price or actual value of the timber stumpage.

The proofs in this case show conclusively that between the time of their purchase in 1908 and the first day of January, 1909, when the excise tax law became effective, plaintiff's timber, lands and other property had so increased in value that they were fully worth the amounts which were deducted from gross receipts as capital assets. It cannot be denied that the plaintiff's standing timber was a part of its capital assets and that the conversion of the timber into lumber and the sale of the lumber constituted at least an indirect sale of the timber and so of capital assets. The mere change of the timber into lumber or money did not transform capital into income. The miller who grinds his stock of wheat into flour and sells the flour does not thereby destroy or impair his capital and convert it into income. The same is true of the manufacturer who converts his cotton into cloth, the landowner who sells his lands for cash, the furniture maker who transforms lumber and other material into chairs and tables, the iron maker who produces steel rails from iron ore and every industrial institution where raw materials are converted into finished or other products or into money. In each instance income is and must be something over and above the original capital investment plus the cost of production and sale. This rule has been uniformly recognised by the Commissioner of Internal Revenue in the decisions and directions issued from his office for the

guidance of the collectors of corporation excise taxes and of the taxpayers themselves.

Standing timber is as staple a product as wheat, cotton or iron. It is a tangible and visible property whose quantity, quality, and market value can be readily ascertained and determined. In these respects it is wholly unlike mineral ores in place under ground. If plaintiff had sold its standing timber on the first day of January, 1909, at its market value, could it be claimed that any part of the proceeds of such sale constituted taxable income because more was realized than the original cost in 1908? Certainly not, for the reason that the increase in value had accrued prior to the time when the excise tax law became operative. If plaintiff had purchased its timber thirty years ago from the Government at $1.25 per acre and had manufactured all of it into timber and sold the lumber during the year 1909 at market prices which prevailed on the first day of that year, could it be claimed that the entire proceeds of the lumber above the trifling purchase price of the timber and the cost of manufacture and sale constituted taxable net income? Can the Government, at least in the absence of specific legislative declaration to that effect, reach back years before the enactment of its revenue statute for a controlling factor in determining the net income of a corporation? Can it ignore a substantial increase in the value of property which has occurred and accrued prior to the taking effect of the tax law and thereby convert into income that which is not income within any meaning of the term? To state these questions is to answer them. Gray vs. Darlington, 15 Wall, 63; Bailey vs. Railroad Co., 106 U. S., 109–114–115.

The rule of apportionment of the increment or increase of values between the years prior to January 1, 1909, and those subsequent to that time, which has been recognized and acted upon by the Commissioner of Internal Revenue, does not aid the Government in this case for the reason that the amounts deducted by plaintiff from its gross receipts as capital assets did not exceed the actual market value of its property upon January 1, 1909. It makes no difference whether such deduction was made nominally on account of depreciation of property or for restoration of capital.

Tested by another well-settled rule that the gain, profit or income of a corporation is that which may be withdrawn or expended without reducing the value of its property or impairing its capital, the contentions of the Government must fail. Every tree cut from the lands of plaintiff after January first, 1909, and manufactured into lumber, cord wood, and other products, and then sold, reduced its property and capital by the exact amount of the value of such standing tree unless an equivalent portion of the proceeds of the sale was substituted therefor. The Government is not concerned with the gains made, profits earned, or income received, whatever their form, by the plaintiff prior to the time when its tax law became operative. Whether a valid retroactive law could be

enacted, need not be determined because no attempt has been made to tax such gains, profits, or income.

The fact that plaintiff carried its properties upon its books at their original cost prices is neither material nor important. More bookkeeping entries can not preclude the Government from collecting its revenues. Nor are such entries conclusive upon the tax payer when it is shown, as here, that they represent and indicate ancient instead of present actual values. The bookkeeper creates nothing. His methods, figures, and records must yield to proven and established facts. Baldwin Locomotive Works vs. McCoach, 215 Fed. Rep., 967; United States vs. Nipissing Mines Co., 202 Fed. Rep., 803.

What has been said of timber converted into lumber, cord wood, and other forest products and then sold applies with even greater force to plaintiff's stump lands and city lots. There was no intermediate transformation of the real estate into other forms of property before its sale. According to the proofs, the lands were sold and converted into money at no more than their actual market value on the first day of January, 1909. On that date they were capital assets and the moneys thereafter derived therefrom did not become taxable income.

While no case exactly in point has been cited, the weight of authority is in accord with the views herein expressed. Stratton's Independence vs. Howbert, 231 U. S. 399; Von Baumbach vs. Sargent Land Co., 219 Fed. Rep., 31; 207 Fed. Rep., 423; United States vs. Nipissing Mines Co., 202 Fed. Rep., 803.

Judgment will be entered in favor of the plaintiff for the amount of the taxes paid by it under protest.

Dated, April 30, 1915.

C. W. SESSIONS, *District Judge.*

33 Judgment.—Entered May 1, 1915.—By Judge C. W. Sessions.

This cause having been brought to trial before the court without jury, and the said court after hearing the proofs and allegations of the parties and the arguments of counsel, having found that the said defendant did undertake and promise in manner and form as the said plaintiff hath in its declaration in this cause complained against him, and having assessed the damages of the said plaintiff, on occasion of the premises, at the sum of two thousand seven hundred thirty-two dollars and two cents ($2,732.02) over and above its costs and charges by it about its suit in this behalf expended, therefore it is considered that the said plaintiff do recover against the said defendant its damages aforesaid, in form aforesaid assessed, together with interest thereon at the rate of five per centum per annum from the twenty-second day of December, A. D. 1913, to this date, and its costs and charges aforesaid to be taxed.

And it is further considered that this judgment shall bear interest from this date at the rate of five per centum per annum.

And upon motion of Myron H. Walker, United States district attorney, and attorney for the defendant in this cause, it is certified by the court that there was probable cause for the acts done by said defendant, collector of internal revenue, and whereof the said plaintiff has complained of him in this behalf and it is further certified by the court that in the doing of the said acts the said defendant, collector of internal revenue, acted under the direction of the Commissioner of Internal Revenue; and it is therefore ordered that no execution issue upon the judgment herein against the said defendant.

Order extending time.—Entered May 18, 1915.—By Clarence W. Sessions, judge.

On application of counsel for the said defendant and by consent of counsel for said plaintiff, it is ordered that the time within which the said defendant may move for a new trial or prepare and settle a bill of exceptions in this cause be, and it hereby is, extended for the period of sixty days and after the first day of May, instant.

24 Order extending time.—Entered June 28, 1915.—By Clarence W. Sessions, judge.

On reading and filing a stipulation of the parties, signed by their respective attorneys, consenting hereto, and upon consideration thereof, it is ordered that the time for filing findings of fact, settling bill of exceptions, making assignments of error, moving for a new trial, or taking such other steps in this cause as the defendant may be advised, be, and it hereby is, extended for sixty days from and after the thirtieth day of June, 1915.

Order extending time.—Entered August 23, 1915.—By Clarence W. Sessions, judge.

On reading and filing a stipulation of the parties, consenting hereto, it is ordered that the time to move for a new trial, settle bill of exceptions, to make and file findings of fact, and to take such other steps as the defendant may be advised, be, and hereby is, extended to the first day of October, A. D. 1915.

Bill of exceptions.—Filed October 25, 1915.

The issue joined between the parties to this cause came on for trial on the twenty-eighth day of March, A. D. 1915, before the
25 Hon. Clarence W. Sessions, district judge of said Western District of Michigan, without a jury, a jury having been theretofore expressly waived by a written stipulation of the parties duly filed therein.

The plaintiff was represented by Norris, McPherson, Harrington & Weer, and the defendant by Myron H. Walker, United States attorney for said western district.

Thereupon the following proceedings were had:

Mr. Mark Norris, on behalf of the plaintiff, stated to the court what the plaintiff expected to prove and the points or contentions of the plaintiff in regard thereto.

L. T. M. Foster, being produced and sworn as a witness on the part of the plaintiff, examined by Mr. Waer, testified in substance as follows:

I reside at Cadillac, Michigan, and am office manager of Mitchell Brothers Company and have been since the latter part of 1908. Prior to that time I was bookkeeper. As office manager I have charge of the bookkeeping; all of the accounting department and the books of account of Mitchell Brothers were under my charge for the years 1909, 1910, 1911, 1912. I made the returns of net income to the Government under the excise tax law for the company during those years.

(Witness is shown certified copy of such return for the year 1909.)

I made that out under the direction of Mr. Charles T. Mitchell.

It is agreed by Mr. Walker that this and the other certified copies produced by him may be offered without further identification.

Certified copies of the returns of plaintiff for the years 1909, 1910, 1911, and 1912, produced by United States attorney, were then offered by the plaintiff and received without objection and marked "Plaintiff's Exhibits 1, 2, 3, and 4," respectively.

"Exhibit 1 is attached to this bill of exceptions."

"Exhibits 2, 3, and 4 were made out upon printed forms like that in Exhibit 1 and an abstract thereof is attached to this bill of exceptions."

Witness was then shown and identified three receipts for taxes paid to the Government by said plaintiff, and the same were offered and received without objection and were marked "Plaintiff's Exhibits 5, 6, and 7," respectively.

Exhibit 5 was for the year 1909 in the amount of $263.02.

36 Exhibit 6 was for the year 1910 in the amount of $552.92.

Exhibit 7 was for the year 1912 in the amount of $771.35.

Witness continuing: The like receipt for the year 1911 is lost. It was for the amount of $562.19 and that is the correct amount paid to the Government for the tax of that year.

Witness is shown and identified letter written by the Commissioner of Internal Revenue to the plaintiff, dated September 16, 1913, and the same was offered, received without objection, and marked "Plaintiff's Exhibit 8," and reads as follows:

Copy.

L. L. S. G. E. F.
J. O. L.

TREASURY DEPARTMENT,
Washington, September 16, 1913.

CT—In re:—Special Excise Tax.

MITCHELL BROTHERS COMPANY, *Cadillac, Michigan:*

GENTLEMEN: This office is in receipt of a report made by Internal Revenue Agent Carnes, Indianapolis, covering an examination of

your books made by General Deputy Collector Cronk for the purpose of checking them with your returns of annual net income for the years 1909, 1910, 1911, and 1912. On the basis of the finding of Mr. Cronk, Revenue Agent Carnes recommends additional assessments against your company for the several years as follows:

For the year 1909	$685.09
For the year 1910	553.63
For the year 1911	391.99
For the year 1912	1,101.81

The greater portion of this proposed tax is predicated upon the inclusion in income of certain amounts omitted in your original returns, such amounts representing the difference between the original cost ($2.25 per thousand feet) of timber and a price supposed to have been charged to the mill for the same, the supposed price being considerably higher than the original cost, thus absorbing a good portion of the profits earned by the company.

As this office understands it, an average of $2.25 per M measures the original cost of the lands, and this is the only amount which the corporation may rightfully exclude from its gross receipts to replace the original investment. In other words, the amount received for the lumber manufactured and sold in excess of the original cost plus the cost of manufacture, etc., is net income within the meaning of the law (section 38, act of August 5, 1909) and constitutes the measure of the tax imposed thereby.

37

It is therefore the opinion of this office that the report of the revenue agent conforms to the requirements of the law and the regulations of the department, and that assessments should be made as recommended.

Before making the assessments, however, this office is willing to consider any representations you may desire to make in answer to the objections raised by the revenue agent to your returns as originally filed. To this end the proposed assessments will be withheld until October 5th proximo.

In this connection you are advised that under the provisions of the act above cited this office is not authorized, in the absence of a waiver, to return a formal assessment for the additional liability for the year 1909, the law providing that the assessments shall be made within three years from the date when the returns were due. Assuming that your corporation is not averse to paying all taxes actually due, you are requested to execute a waiver substantially in in the terms of the enclosed form and forward the same to this office.

In the absence of such waiver or the voluntary payment of the tax for 1909 this department will be under the necessity of instituting proceedings in court looking to the collection of the same.

Respectfully,

W. H. OSBORN,
Commissioner.

TB. Enclosure: Form of waiver.

Plf. Exhibit 8, March 18, 1915. C. Hendelink, reporter.

Letter of plaintiff to the commissioner, dated September 30, 1913, produced by the United States attorney, identified by the witness, and offered and received without objection, marked "Plaintiff's Exhibit 9."

In substance, it asks the commission for further time in which to make the showing required and encloses the waiver requested by the Commissioner of Internal Revenue. The witness identified another paper offered, and it was received in evidence without objection and marked "Plaintiff's Exhibit 10," which in substance is an extension of time by the commissioner to the plaintiff to make the required showing.

Witness identified letter of plaintiff to the commissioner, dated October 9, 1913, and the same was offered, received without objection, and marked "Plaintiff's Exhibit 11," and asks for a further extension of time until October 30.

38 Counsel offers paper received from commissioner by plaintiffs, dated October 17, 1913, and granting an extension of time until October 30, 1913, and the same was received without objection and marked "Plaintiff's Exhibit 12."

Plaintiff offers letter to commissioner from Mark Norris of date October 28, 1913, submitting the brief in answer to the order to show cause, issued by the commissioner against the plaintiff, which letter was received without objection and marked "Plaintiff's Exhibit 13."

Plaintiff offers letter from the commissioner to Mr. Norris, dated December 4, 1913, and the same was received without objection and marked "Plaintiff's Exhibit 14," which reads as follows:

Copy.

J. O. L. E. C. J.
B. G. M. L. F. S.

TREASURY DEPARTMENT,
Washington, December 4, 1913.

CT—In re:—Special excise taxes.
MARK MORRIS, Esq.,
Attorney at Law, 731–731 Michigan Trust Bld.,
Grand Rapids, Mich.

SIR: Referring to your brief filed in connection with the additional special excise taxes recommended by the revenue agent against the Cummer-Diggins Company, of Cadillac, Michigan, and the Mitchell Bros. Company, of the same place, for the years 1909, 1910, 1911, and 1912, you are advised that this brief has been given very careful consideration, but this office does not agree with your contention that the amount which is the measure of the additional taxes recommended (the difference between the value of the stumpage cut

during the years 1909, 1910, 1911, and 1912, as shown by the corporations' books and the actual book value of the same stumpage December 31, 1908), should not be taxed because, first, such value is "unearned increment," constituting increase of capital assets and is not income within the meaning of the law; and, second, because such value, if income at all, was not "income" received during the years for which the additional taxes are claimed to be due.

This office is of the opinion that the gain from the cutting and disposal of stumpage is realized in the year during which the timber is cut and disposed of and that the amount realized over and above the cost of such timber is profit and should be so accounted for as income for that year. No allowance for so-called
89 unearned increment can be considered in arriving at the gain to be accounted for as income for the purposes of the special excise tax on corporations and only the cost of the timber or the value at which it was carried on the books of the corporations as of January 1, 1909, can be deducted on account of exhaustion of capital assets.

Therefore, the additional special excise taxes recommended by the revenue agent against these corporations appear to be in accordance with the rulings of this office in many similar cases, and the additional taxes will be assessed accordingly.

Respectfully,

W. H. OSBORN,
Commissioner.

OC. Plf. Exhibit 14, March 18, 1915, C. Hondelink, reporter.

Plaintiff offers letters from Mark Norris to Commissioner of Internal Revenue dated December 3, 1913, and asking appeal from the decision of commissioner to Secretary of Interior. Letter marked "Plaintiff's Exhibit 15."

Plaintiff offers demand, dated December 12, 1913, from George Clapperton, collector of the fourth district, to plaintiff notifying plaintiff of an additional tax amounting to $2,732.02, demanding its payment on or before December 22. The same was received without objection and marked "Plaintiff's Exhibit 16."

Also letters from the commissioner to Mr. Mark Norris, under date of December 15, 1913, denying the appeal to the Secretary of the Treasury and the same was received without objection and marked "Plaintiff's Exhibit 17."

Also letter from plaintiff's attorney to Clapperton, collector, dated December 22, 1913, enclosing draft for $2,732.02 for additional assessments for the four years in question. The same was received without objection and marked "Plaintiff's Exhibit 18" and is as follows:

"DECEMBER 22, 1913.

HON. GEO. CLAPPERTON,
Collector of Internal Revenue, Grand Rapids, Mich.

DEAR SIR: As attorney for Mitchell Bros. Co. of Cadillac, Michigan, we herewith enclose Grand Rapids exchange in the sum of

$2,732.02 in payment of additional assessments of special excise taxes under the act of Congress of August 5, 1909, as follows:

1909	$685.09
1910	553.63
1911	391.99
1912	1,101.31

We desire it understood that the payment of these taxes is made under protest, that said taxes were illegally and wrongfully assessed and collected because the character of the assets assessed as income was and is capital and not income within the meaning of the act of August 5, 1909. In issuing receipts for the payment of these taxes, kindly let the receipt show that the payment was made under this protest.

Very truly, yours,

NORRIS, MCPHERSON & HARRINGTON.

LWH–O Enc."

Also the collector's receipt for the amount of the additional taxes. The same was received without objection and marked "Plaintiff's Exhibit 20." It is dated December 22, 1913, is for the amount and years stated, signed by George Clapperton, collector, and has written across the face "Paid under protest."

Also certified copy produced by the United States attorney of claim for refund of such tax, filed December 22, 1913, signed by Charles T. Mitchell, made on United States Internal Revenue Form 46. The same was received without objection and marked "Plaintiff's Exhibit 21."

Also letter from Collector Clapperton to plaintiff, dated December 23, 1913, acknowledging receipt of the additional excise tax, etc. The same was received without objection and marked "Plaintiff's Exhibit 22."

Also letter from Collector Clapperton to plaintiff, dated April 13, 1914, informing it of the rejection by the Treasury Department of their claim for refund of the additional excise tax, and returning receipt. The same was received without objection and marked "Plaintiff's Exhibit 23."

Witness continuing: This document which I have is a recapitulation of the accounts for the calendar year 1909. It was made for the purpose of showing the amount of income that we were to pay. It had been made because our fiscal year closed September 30th. In ascertaining our income for the fiscal year 1909, we could not use our books as they stood. We had to deduct three months and add three months to our fiscal year in order to arrive at our income, and in doing that the statement was made up. In making up our return of income for the year 1909 we made up this statement, and included in it all of the income-producing accounts, all of the depreciation accounts, and all of the expense accounts on our books, and this statement contains all the accounts which would go into a statement of income for the calendar year 1909.

41 Q. Explain briefly how you got the amount of gross income which appears upon the income tax return as $303,685.03?

Witness continuing: The first item is lumber and we arrive at our income on lumber by taking the inventory of lumber on hand, deducting the expense accounts, crediting that account with the sales and the new inventory and the difference being the gain, the net income from lumber is $83,487.26. That was income after deducting the expense of operation. The other items that went to make up this gross income are, income on electric light, bark, siding, chemical fuel, chemical wood, flooring, flooring plant, wood operation, store, chemical company dividends, machine shop, rents, special lumber and flooring, shingles, water rents, saw mill wood, stump land. To arrive at the gross amount of net income we added together the net income from all these various items of operation and the amount is $303,685.03.

Mr. Waer. That was put in the return as gross income?

Mr. Walker. But it is the result of all these income producing accounts as shown by the books?

Mr. Waer. Yes.

The Court. In reality you have made the deduction.

Mr. Norris. Of the operating expenses.

Mr. Waer. Not including taxes and interest, which are made later.

Witness. The item of total depreciation shown on this tax return for the year 1909 was arrived at by deducting the depreciation of the various properties, the stumpage depreciation at the market value prices, depreciation on the stump land and the wood timber, the total of which was $174,421.37.

Q. Among those items of depreciation are the ones upon which the Government made a re-assessment, and those which have been spoken of in this case; what are they for the year 1909, not the amounts but the items?

A. The stumpage, the stump land, and the wood timber."

Witness: Besides those items there is included in the depreciation item in the return, depreciation on the barn account, camp tools and stock, camp buildings. The rest are all depreciation on the operating facilities.

In the return of net income for the year 1909, there is no amount under item 4 because the expense of maintenance and operation of the business are all taken out in these other accounts and appear and are taken out with each separate operation. That is, the ex-
42 penses incident to the lumber operations were taken out of the lumber account, and so on with the other operations.

Q. "State in a general way where you obtained these figures on this statement.

A. It is taken from the books."

The statement referred to was marked "Plaintiff's Exhibit 24."

The Court. Where did you obtain the deductions for depreciation on account of stumpage?

Mr. Waer. You mean the number of feet or the dollars—the price per thousand?

The Court. Yes.

The Witness. From Mr. Charles T. Mitchell.

Mr. Walker. That is not on your books?

The Witness. No, sir.

Mr. Walker. I wish you would state what portion is taken from the books and what is not, if you can draw the dividing line.

The Witness. Yes, sir. The stumpage value per thousand feet is not taken from the books; the wood timber per cord is not taken from the books."

Q. (By Mr. Walker.) "How much of the depreciation—total depreciation of $174,421.37 is shown upon the books? How much of those figures that you have there footed up to make that amount on that sheet now before you appears on the books and is taken from the books, what ones of those items?

The Court. I take it, from his former answer, all except two.

Mr. Walker. Is that right?

The Witness. Yes, sir.

Mr. Norris. There is fifty-one odd thousand dollars depreciation, I think that is the amount.

The Witness. It would be sixty-one thousand on the books.

Mr. Walker. Sixty-one thousand on the books?

The Witness. Yes, sir.

Q. (By Mr. Waer.) The sixty-one thousand dollars depreciation on the books is composed of what items?

A. Items of this property used in the manufacturing.

Q. That is the depreciation—

A. And the stump land account.

Q. On the operating end of it?

A. Yes, sir.

Q. What depreciation, if any, appears on the books with reference to the stumpage cut and converted during the year 1909 as shown by that statement, without giving the amount, you don't have to give the amount if you don't know it now.

43

A. It would be stumpage at $2.25 and $3.00; that would be on the books.

Q. With reference to the stump land, what item of depreciation, if any, is on the books?

A. It would be substantially the same; the acreage might vary between the fiscal year and the calendar year, but substantially the same.

Q. At what amount is the depreciation on the books of the stump land?

The Court. He means what amount per acre.

A. Two dollars per acre.

That is in stump land account and $2.25 and $3.00 appears in stump account.

Q. "So I understand you to say all the items of depreciation on this statement appear on your books except the difference in the depreciation charge made against the stumpage, that difference being ascertained by the two and a quarter and eight dollars?

A. Being less than the amount we charge back, and also the difference on the stump land, being between the two dollars that we charged—that the Government permitted us to charge back, and what we charged back.

Q. Aside from that all the terms of depreciation on this statement are on the books?

A. That is not exactly correct regarding the stump land. Whatever the profit on the stump land was for the fiscal year is on the books, just the same as it is for the calendar year. That depreciation is the gain arrived at by crediting the account with the sales, deducting whatever is turned over during the year at two dollars per acre, and the cost of maintenance.

Q. The amount of depreciation against stump land is $8,607.11?

A. Yes, sir.

Q. What proportion of that, if any, appears upon the books of the company?

A. It is all upon the books.

Mr. Walker. In what form does it appear on the books of the company, if I may ask the question?

Q. Does it appear as a depreciation charge?

A. No, it does not appear as a depreciation charge; it is a loss and gain account.

Q. Does it appear as a depreciation charge to the extent of the two dollar charge?

A. Yes, sir.

When any lands are sold in any given year we credit stump
44 land account with the amount realized for the land sold, and the balance less any expense of making a sale, is treated as profit and carried to profit and loss.

The Court. "In making out this return you either assumed or determined that on the thirty-first day of December, 1908, the stump lands were worth the amount for which you sold during the year 1909, did you not?

A. Yes, sir. Whatever the gain was to the account was put in as income and it was taken out as a depreciation.

Mr. Walker. That is, in making returns?

A. Yes, sir; in making returns."

The item of depreciation on wood timber, that is, fire wood, does not appear in any way upon the books of the company as a depreciation item.

The above statement heretofore market "Plaintiff's Exhibit 24" is offered in evidence "as showing the manner in which the return of annual net income for the year 1909 was made up and received without objection for that purpose. Exhibit 24 is attached to bill of exceptions.

(Witness identifies statement made up to show the annual net income for the years 1910, 1911, and 1912.)

They are made in the same manner as the one for 1909 was made. Referring to the 1909 statement and the items of depreciation therein, the same facts are true of this statement as to the stumpage, the stump land and the wood timber as the statement for the year 1909.

Q. "So that as far as depreciation is concerned, where these are book entries on this statement they are the same as they were on the 1909 statement?

A. Yes, sir."

This statement was made up the same as the 1909 statement. These items of depreciation of old office property $1,500 and on the Grand Rapids real estate $200 appear upon the books as a profit and the property sold. They do not appear as a depreciation charge.

The 1910 statement is offered and received without objection, marked "Plaintiff's Exhibit 25," and is attached to this bill of exceptions. Same with 1911 statement marked "Exhibit 26" and attached to bill of exceptions.

The 1912 statement was made up in the same general way as the 1909 statement. The same was offered and received without objection and marked "Plaintiff's Exhibit 27" and is attached to bill of exceptions.

The item contained in Exhibit 27 under depreciation of
45 cedar products, amounting to $6,351.13, does not appear as a depreciation charge on the books of the company.

The like item is to square timber $5,957.07, does not appear as a depreciation item on the books of the company.

Q. "Does it appear on the books as a depreciation charge of $2.25 and $8.00 stumpage charge?

A. Yes, sir.

Q. And is that the only way?

A. Yes, sir."

In answer to the court the witness stated that as to the cedar products the amount deducted for the purpose of the income-tax returns for depreciation is the entire receipts less the cost of producing.

As to the square timber account, there was deducted a small cost for scaling and the stump value of $2.25 and $8.00 per thousand. The account was credited with the receipts and the difference was taken out as depreciation.

As to the stump land there was deducted the total amount received for the land less any incidental expense and $2.00 per acre. We did not in that case attempt to determine the value of the land on the thirty-first of December, 1908. We took the balance of the account. In determining that, it was our opinion that they were worth December 31, 1908, whatever they brought when they were sold, less the cost of selling and the charge of $2.00 per acre. Some of the lands brought more than others, but we took the account as a whole for the year.

The Court. "On December 31, 1908, cedar timber had a value, did it not, that could be estimated?

A. I never heard of any cedar being valued by stumpage or in that way; it is always sold by the piece. If you have forty acres of cedar swamp, why you sell it for so many dollars."

The Court. It is not valued by the thousand, but it is valued by the number of poles or ties.

A. Not to my knowledge; no, sir.

The Court. Or the number of posts that it will produce?

A. No, sir; not to my knowledge.

The Court. Certainly they do not guess at it, do they?

A. Yes, sir; absolutely.

The Court. The guess is based upon something. In other words, a man who has a knowledge of cedar timber could tell approximately how much forty acres of timber or an acre of timber was worth?

46 Mr. Norris. We will try and show your Honor that by a later witness, an expert in cedar products.

The Court. What I was getting at here was why a difference was made in the method of computation, instead of the same method being followed with reference to these different items.

Q. (By Mr. Waer, resuming.) Mr. Foster, you merely made computations of these items in accordance with instructions given you by Mr. Mitchell as to how you were to figure them out?

A. Yes, sir.

Q. You yourself did not determine how the depreciation charge was to be made?

A. I took the matter up with——

Q. Except as a matter of bookkeeping?

A. I took the matter up with Mr. Mitchell before it was done.

Q. Was it your understanding that these cedar products and square timber products and stump lands were charged back at the amount received for them on the theory that they had not increased in value from January, 1909, to the time they were sold?

A. Yes, sir."

On January 1, 1909, plaintiff's timberlands were located in Missaukee, Kalkaska County. This plat which you showed me shows the amount owned by the Mitchell Brothers Company, situated in Orange Township, Springfield and Garfield, in towns 24–7 & 8, 25–7 & 8, 26–7 & 8. This plat shows the location of lands, of railroads, towns, rivers, and so on.

The plat is offered for the purpose of showing such location in a general way only. Received and marked "Plaintiff's Exhibit 28." These lands were purchased in 1903 by the corporation. That is as far as I know. The corporation was organized June 22, 1908. The books of the corporation show that these lands were taken over by the corporation from the copartnership at approximately $20.00 per acre.

(Mr. Walker calls for the production of the books showing such entries.)

Q. "What record, if any, have you in the books of the present corporation showing at what value the lands were taken over, or how they were valued by the corporation after they were taken over?

A. We have an inventory of the lands September 30, 1908."

Witness produced inventory book and stated that it contains
47 the inventory of the timberlands and of all property of the plaintiff company taken September 30, 1908, the end of the company's fiscal year.

That shows the plaintiff's timber lands at 22,063 acres, inventoried at $440,031.96 and commencing on page 91 of the inventory book.

The Court. That is about $20.00 an acre.

It also shows 1,640 acres of standing timber without the lands, valued at $8,658.00 and stump land 9,041 acres valued at $12,110.27. That means the land without the timber. That is a summary of all the items upon which a separate value is put. The inventory shows the different prices per acre.

From the year 1909 the valuation of this timber land upon the books of the company has never been changed up to the present time. The taxes charged upon these lands was absorbed in the year's business. No increase in the market value of the land was ever taken account of on the books of the company. There has been no carrying charge made to the land or the timber. These timber lands were carried upon the books of the company in timber land account. The plaintiff made no sales of its timber or timber lands, as such, during the years 1910, 1911, and 1912. We manufactured our timber and were not selling it. When the timber was cut and manufactured into lumber, the proceeds of the operation would appear in the lumber account and by-products, stump land, bark, chemical wood and flooring, and not in timber land account which is not carried as an active, income producing account. At the end of the fiscal year the timber land account would be credited with the stumpage cut at 2.25 for hardwood and hemlock and $8.00 per thousand for pine. That would be charged to lumber account.

Witness produced and identified the account book as the cash journal of the plaintiff, one of the books of original entry usually kept in its business. We carry on our ledger what we call a "closing log account" and charge to that account the stumpage cut, at 2.25 and $8.00 per thousand as stated and also charge it with the cost of cutting and hauling to the mill and then close it by charging to the lumber account, the amount which the account produces.

In the year 1909 this closing log account was charged with timber lands, that is the stumpage $60,916, the real estate, standing timber $2,131.00. That would transfer into closing log account the items transferred from timber land account. The closing log account is charged with the labor, the loading, the railroading and so on.
48 And the balance that shows in that account is charged to the lumber account, thereby getting all the cost and stumpage into lumber account.

That timber land item, $50,916.00, goes into closing log account and is made up of stumpage at $2.25 and $8.00 a thousand and that alone and that includes all timber stumpage cut from lands of Mitchell Brothers Company on the fiscal year of 1909.

"Q. Just what is the purpose of the closing log account?

A. It is an account that we use simply for combining the timber and the cost of getting the timber to the mill.

Q. That is, it is a mid-way step between the timber land account and these other operating accounts; you transfer the items into the logging account in order to close your books, and transfer them out of there into the other accounts?

A. Into the lumber account.

The Court. It is only for the purpose of keeping it separate?

A. Yes, sir; separating the woods operation from the lumber.

The Court. That account is balanced?

A. Yes, sir.

Q. That is, it is an account that is used only while you close your books and only for that purpose.

A. Unless there might be a small inventory of logs in the woods, something like that. That is all that would appear in that account."

I know this value of $2.25 and $8.00 per thousand has been used every year since the incorporation in 1903 as a means of transferring the timber stumpage cut into the lumber account. For the years 1910, 1911, and 1912 these entries were made on the books in the same way as in 1909, stumpage cut from timber land transferred into lumber account, and the number of acres of timber land cut is credited with $2.00 per acre and the stump land charged for the year 1909. This entry is on page 56. It shows the real estate, stump land, charged with $1,840, the timber land credited with the same amount. That was to transfer the cut over land from the timber land account into the stump land account. The closing log account is on pages 56 and 57.

The figures charged back in these income tax statements for these four years for the various kinds of lumber was per thousand, hemlock $4.00, maple $4.00, beech $2.00, birch $4.00, elm $8.00, ash $8.00, cherry $10.00, basswood $8.00, oak $10.00, and pine $20.00. I do not know how these prices were arrived at. They were given me by Mr. Charles T. Mitchell.

For the year 1909 the quantity of stumpage charged back and included in the return as depreciation was 25,252,481 feet at an average price of $4.33 per thousand, a total amount of $109,927.04.

We arrived at the amount of stumpage cut during the calendar year 1909 by taking the total cut for the fiscal year amounting approximately to 23 million feet, deducting from that the last three months of 1908, October, November, and December, amounting to 6,000,000 feet, leaving 16 million feet, cut for the nine months in 1909. To this we added the latter three months of 1909, amounting to 8 million feet, making for the calendar year 24 million feet. We

had an inventory at the beginning of that year of 550,000, making the total above stated.

We have a record which we call the log book in which is entered month by month the kinds and amounts cut. We have a desk sheet which we keep that shows each month's cut by itself. From these we get the total of the three months and we make up this statement in that way.

The statement referred to offered and received without objection and marked "Plaintiff's Exhibit 29."

The 1910 statement shows the quantity of stumpage charged back as depreciation for that year to be 24,404,616 feet at the amount of $104,088.33 and an average price of $4.26 a thousand. We arrived at the quantity of timber cut and the amount of stumpage for the calendar year of 1910 the same as for 1909 and this statement is made up in the same way as the previous statement.

Statement offered and received without objection and marked "Plaintiff's Exhibit 30."

The statement for 1911 shows stumpage charged back as depreciation 19,819,388 feet, total $83,908.56, an average of $4.21 per thousand. This was arrived at in the same manner as that for 1909.

Statement offered and received without objection and marked "Plaintiff's Exhibit 31."

The statement for 1912, stumpage charged back 27, 490,795 feet, total $122,007.23, average price $4.44 per thousand, was arrived at in the same way as that for 1909.

Statement offered and received without objection and marked "Plaintiff's Exhibit 32."

50 I can tell from the records the average cut per acre for the fiscal years and not for the calendar years: For 1909, 17,494 feet. For 1910, 16,322 feet. For 1911, 14,121 feet. For 1912, 18,906 feet.

These statements giving the amount and various kinds of stumpage charged back for these years and upon which our income tax returns were based, were taken from these last four exhibits and are correct. The cut over lands were carried on the books as real estate stump lands.

When the timber was removed the cutover lands were charged to that account at the close of the fiscal year at $2.00 per acre. This has been so since 1906, since the organization of the corporation. In the same way as the timber was transferred into the lumber account.

The amount of $8,607.11 appearing in the income statement for the year 1909 and charged back as an item of depreciation stump land, was arrived at by taking the inventory of the stump land January 1st, 1909, adding to that the cutover land at $2.00 per acre and the expense of selling, crediting it with the amount of sales, and this $8,607.11 was the net gain shown by the book account at the end of the calendar year. Sales of stump land were all made by Mr. Caldwell. For the year 1910 the amount $8,284.01 of the stump land was the gain for the fiscal instead of the calendar year. That was done

because at the end of the calendar year we had to estimate the acreage—in order to get at it for the calendar year we had to estimate the acreage cut over. At that time of the year the cut is very irregular, therefore we could not get at the acreage closely, so we decided we better change our plan and use the fiscal year from that time on. The effect of this was that we accounted for the three months ending 1909 twice and we deducted the $3,284.01 from the gross income as shown by the returns for the year 1910. For the years 1911 and 1912 we used the fiscal year also. This item of $3,284.01 is included in the return under income and also included under the depreciation charged back, so as to the net income it would make no difference. The amount charged back in 1910 was arrived at and computed in the same way as for 1909, except it was for the fiscal year instead of the calendar year.

For 1911 the depreciation for stump land charged back was $1,819.72. For 1912 it was $19,486.59, which was arrived at the same as for 1910. The correct amount for 1912 was in fact $18,059.83, but this item of $19,486.59 was included in the return of income and also charged back as depreciation for that year and makes no
51 difference in the final net income. I do not know how the mistake was made.

In the calendar year 1909 there was charged back as depreciation on wood timber account $4,023.00. That was 16,092 cords of wood at 25 cents a cord. For 1910, $4,379.25 for 17,517 cords at 25 cents. For 1911, 5,454.75 for 21,819 cords at 25 cents. For 1912, $4,757.25 for 19,029 cords at 25 cents per cord.

The amount derived from this wood timber appears in the chemical wood account. The account is charged with the cost of producing the wood and credited with the sales and no stumpage was charged against it and has never been, and the wood timber was never taken into account on the books of the company.

We arrived at the number of cords of wood timber to be thus charged as follows:

For the fiscal year 1909, 27,099 cords cut in the mill. We deducted the amount cut in the last three months of 1908, added the amount cut for the last three months of 1909, which made a total of 27,191 cords, and from this we deducted one-third of the slabs which came off the saw logs. That would leave for the calendar year 18,128 cords. I am unable to explain the difference in the return of 16,092. The percentage deducted for slabs had already been included in the value of the timber, so we deducted that amount.

In the year 1910 we used the same method for the mill cut, excepting that we had the wood cut out in the woods and this was included and we deducted one-third for the slabs. In 1911 we deducted one-fourth for the slabs, as we found we were not getting the stumpage we should have on the former basis.

In the year 1912 we took the amount of wood cut in the woods. This we added—we took the number of cords of wood logs at two and two-thirds cords per car, adding the two together, making the

total cordage for the calendar year. We made comparative tests by selecting two cords of wood logs, having it sawed up into four foot wood and piled, one in 1912 and the other recently. The first was done by our camp foreman under my direction; the second by myself.

In 1912, $5,957.07 was charged back as depreciation on so-called square timber. This was rock elm, and a very little pine was taken out for ship timber by the purchaser. We scaled it. We sold at 32 cents per cubic foot for elm and 40 for pine. This account was charged with the scaling, with stumpage charge, $2.25 52 and $3.00, credited with the sales and the balance was gain included in the income and the same amount taken out as depreciation.

Q. "This morning when I spoke about the statements for the various years I asked you whether or not these items of depreciation appearing on those statements were included in the company's books or appeared upon the company's books, with reference to these items of $2.25, $3.00, and $2.00 charges, and I think you stated that they appeared as depreciation charges on the books. Now, are they depreciation charges or what are they?

A. I would not say they are depreciation charges. The accounts are charged and the timber land is credited with the stumpage at that price in our regular bookkeeping."

In 1912, under the head of cedar products, there is charged back $6,351.13. That was included in the return of income for that year and deducted as depreciation. Those cedar products were generally poles, posts, ties, and shingles. The whole account was closed in 1912. This cedar was taken from lands in Town 26-7. The account was charged with the cost of production, credited with the sales, and the difference represented the gain or the income. This amount of $6,351.13 was included in the gross income for the year 1912, and the same amount deducted under the head of depreciation for the same year as so much capital used up. This statement shows all of the cedar products sold appearing in this account.

Statement offered and received without objection and marked "Plaintiff's Exhibit 33," and attached to this bill of exceptions.

In the income statement for 1910 there is a depreciation charge on Grand Rapids real estate of $200.00. This parcel was carried upon the books in real estate account at $500.00 and has been since 1903. It was sold May 5, 1910, for $700.00 net to the company. We show in our statement for the year 1910 an income of $780.12, $580.12 from interest on contracts and $200.00 from this sale. We included the $200.00 on the whole $700.00 in our income, and charged the $200.00 back as depreciation.

In this statement also is charged depreciation on office property in Cadillac. On the books it stood since 1903 at $3,500.00. It was sold January 31st, 1910, for $5,000.00. The $1,500.00 was included as income and deducted as depreciation. Nothing was charged against real estate from 1903 to and including 1908 for taxes on these

two parcels. It was carried at the original price and the taxes were absorbed in each year's business.

53 Cross-examination by Mr. Walker:

This book which I had this morning containing closing log account, stumpage account, etc., at the close of the fiscal year 1909, is the cash journal. The purpose of closing these accounts each year is to arrive at the condition of the business of the company at that time, its profits or losses, and these profits are carried finally into profit and loss account which appears in the ledger for those years.

(Witness turns to profit and loss account for the fiscal year ending September 30, 1909.)

The amount of profit, the final balance for that year, as shown from that account, is $202,280.93. All these income producing accounts were finally closed into and are included in that profit and loss account. The balance of the profit and loss account, as shown for the subsequent fiscal year ending September 30, for 1910, $282,644.74; for 1911, $187,953.20; for 1912, $252,308.53.

I have not the balance of the profit and loss account shown by our books for the calendar years of 1909, 1910, 1911, and 1912.

"Q. You did have them, did you not, at the time the returns were made? You averaged it or figured it out in some way?

A. We didn't have it in that way.

Q. In making your returns for these years, if I understand you aright, you first had to ascertain, did you not, your net income—your gross income and net income for each one of these calendar years according to your books and then reduce that amount by these depreciation charges that you have been testifying to; is not that the way you did it?

A. We did not go through and make a balance sheet and close the books up to show the profit for the calendar year.

Q. What did you do?

A. We started in with the lumber account and took the inventory, credited sales and took out the expense and reduced that to show what it gained, and also all the other accounts that way.

Q. You took your inventory taken at the close of the fiscal year, did you not, or did you take a new inventory?

A. Yes, sir.

Q. Of the calendar year?

A. Yes, sir.

54 Q. You took a new inventory?

A. Yes, sir.

Q. Having taken a new inventory at the end of the calendar year you could take the state of the income producing accounts on your books and ascertain the profit and loss at the end of the year, couldn't you?

A. We could, but I have not those figures.

Q. I ask you if you did not do that as a matter of fact as the basis of the return that you made to the Government from which you made these deductions of depreciation?

A. No, sir; we didn't go so far as to take off a balance sheet to arrive at what the profit would be for the calendar year.

Q. If you did not get it from your books, how did you get it, did you estimate it?

A. We got what we show on the return from the books.

The Court. You mean that you took a trial balance instead of a final balance as it is called?

A. We did not take a final balance and arrive at a gain for the calendar year; we took each account and went through and took the charges and the credits for the year—the inventories.

Q. Tell me this: What did you show as your net income for the calendar year ending December 31st, 1909, from your books upon which you based this return?

The Court. You mean before the deduction of anything for depreciation?

Mr. Walker. Yes.

The Court. Or before any deduction?

Mr. Walker. Before any deduction for depreciation; that is the deduction that he made.

A. We showed $303,685.63."

We showed our gross income $303,685.63 for the calendar year ending December 31st, 1909, from our books, and before any deduction was made for depreciation. From that we took interest $21,141.13, taxes $19,820.79, depreciation $174,421.37, less dividends received upon stock of other corporations, etc., $57,000.00, showing the net income for that year $31,302.34.

Q. "How much of that $174,421.37 did you deduct as depreciation for that calendar year, how much was deducted from your books as depreciation, or for any other purpose from your net income or profits, if any?

A. $51,864.22 on the property accounts.

The Court. That was mill machinery and equipment?

A. Yes, sir.

55 Q. Any more?

Q. Then there would be the difference—the stumpage is taken out of the return and the stumpage as put in the books, $2.25 and $8.00 per thousand.

Q. The $2.25 and $8.00 per thousand don't appear upon your books as a depreciation or a deduction anywhere, does it, from your profit and loss account?

A. No, sir.

Q. In other words, all this depreciation made in the return, $174,421.37, except $51,854.22, is depreciation that is figured or estimated or made, as the case may be, for the purpose of the tax return?

A. Yes, sir.

Q. "And no part of it for the purpose of the ordinary business of the company, as shown by its books or its transaction upon its books?

A. No, sir.

Q. "And that report does not make a deduction of any portion of this $174,000.00 except fifty-one thousand odd as depreciation, or making good capital assets or for any other purpose, does it?

A. Of course in those books the stumpage value is charged in at the $2.25 and $8.00.

Q. The stumpage value is credited in one account and charged to another?

A. Yes, sir.

Q. One hand washes the other, the accounts balance so far as that stumpage value is concerned?

Mr. Weer. This stumpage account and your lumber account.

Q. Is that right?

A. It is charged to one account and credited to the other.

Q. Then I return to the question: It is a fact, is it not, that in the annual report of the business of the year made by the directors showing profits, all of these so-called depreciations, except the fifty-one thousand odd dollars, goes into profit account—is shown as a profit?

A. Yes, sir.

Q. Dividends are declared by the company, are there not?

A. Yes, sir.

Q. Dividends are declared from time to time upon the basis of these annual accounts showing profits, are they not?

A. Yes, sir."

56 There is a surplus account to which is carried portion of the profits shown by the annual reports not declared as dividends.

The plaintiff company is a lumber manufacturing company, organized for the purpose of owning and cutting timber from timber lands, manufacturing it into lumber and selling it and making use of the various by-products. That is its sole business. It is not a real estate trading corporation. It has its own mills, owns its own stumpage, cuts and manufactures that stumpage into lumber, sells it and makes its profit in that way, together with its receipts from the by-products, such as wood sold to chemical companies, etc.

The inventory book to which I refer is not an inventory of timber stumpage by the thousand. It is an inventory of so much land that the company owns, described by sections and townships at so much an acre. It does not show the estimated amount of timber of any kind upon these lands nor the price per thousand. No one could tell from that book either how much timber there is or what its value is on these specific parcels. The record is by the acre.

I do not know when nor where nor by whom it was that this charge was fixed at $2.25 a thousand and $8.00 a thousand. I think we had this closing log account the first fiscal year of this company ending 1904, and that we charged into it the amount of timber cut at the same price per thousand, $2.25 and $8.00. I do not know how much that timber cost the company nor are there any books or documents here that will show the estimated number of thousand feet per acre of those lands in the inventory books. There was no other carry-

ing cost of these lands than taxes. These taxes were not charged to the particular parcel of land but to the general expense account for the year and deducted from profits, that is during both before and after December 31, 1908.

It was after the close of the calendar year 1909 that Mr. Mitchell and I first undertook to determine the basis upon which this tax return should be made for the year 1909, some time between the first of January and the 23rd of February, 1910. Up to that time there had been no re-inventory of the stumpage lands nor of the timber stumpage, nor has there been since that time.

Q. "In other words, nobody has gone over those lands, estimated the timber, looked at its condition and estimated or figured what it was worth per thousand as it stood there in its condition per thousand?

No, sir.

57 Q. What was done that you and Mr. Mitchell, the vice president got together and in view of the fact that this tax return had to be made, Mr. Mitchell instructed you how much valuation you were to put upon the various kinds of timber that had been cut for the calendar year 1909, for the purposes of this return?

A. Yes, sir."

It was fixed at the price per thousand hereinbefore stated for the different kinds. That has remained the price for that purpose from that time to the present. That is its stumpage value. The entry upon the cash journal for the fiscal year ending September 30, 1909, so far as it relates to the timber stumpage debits closing log account with $54,048.06, credits stumpage of that amount, fifty thousand, $916.93, for that portion of the logs cut from the timber lands owned by the company and credits stumpage $3,131.13 for that portion of the logs cut from standing timber but not the lands owned by the company. This amount of $54,048.06 stumpage is the stumpage cut for the year at $2.25 and $8.00 a thousand, and finally goes into lumber account for the year and the balance of lumber account goes into profit and loss account. The credit of lumber account represents the profits of all lumber sold during the year. The deductions made from the tax returns for depreciation at the average price of $4.33 a thousand stumpage for 1909, $4.26 for $1910, $4.21 for 1911, and $4.44 for 1912, was not in addition to the charge of $2.25 and $8.00 a thousand, made for stumpage into the lumber account. That was eliminated entirely.

The Court. So far as this stumpage is concerned, this controversy involves the difference between $2.25 and $8.00 per thousand, and the amount that was actually deducted, the $4.21 one year and $4.44 another year.

Mr. Morris. That is it exactly; that is what this controversy is about so far as the stumpage is concerned.

The Court. Instead of $2.25 and $8.00 on the one side and from two to twenty dollars on the other side.

Mr. Walker. But the summary of it is that it amounts to the difference between the $2.25 on the one side and the average rate of $4.83 on the other.

The Court. Precisely.

Mr. Walker. Which, in the final result, is the same thing in dollars and cents. Yes, your Honor, that is what this controversy is about, although the Government does not concede that the company is entitled to make any deduction.

55 The Court. But you have conceded, or at least the Commissioner of Internal Revenue conceded it, by making the assessment on the basis of $2.25."

Mr. Walker. I understand that very well, and I am not going to try to recover it back in this suit; but what I mean, in principle the Government does not concede it.

The Court. I am inclined to think the commissioner will have to stand by his assessment.

I think we have the price at which the stumpage lands were sold per acre in 1909, 1910, and 1911 and 1912. They show the following among other sales for the year 1909: 80 acres at $7.00 an acre; 40 at $2.50; 40 at $2.50; 80 at $10.00; and 40 at $7.00. It shows sales at prices varying from $2.50 an acre to $12.00 an acre, with the exception of one parcel sold for $1.25 per acre. These statements of stumpage land sales produced by the witness for the years 1909, 1910, 1911, and 1912, offered by the Government and received in evidence and marked "Government's Exhibits A, B, C, and D."

When these stumpage lands were sold there was nothing on them in the way of stumpage. I could not say as to wood timber. The rule is not to charge them into stump land account until all the forest products of any value were taken off and that would include wood timber. We have abandoned the cutting of cedar on these lands and are not manufacturing any more of it. We sell it as it stands. We do not keep an account on our books with each parcel of land as the timber is cut upon it and there is no way of telling from our books where the timber has been cut off from these parcels of land carried in the inventory book and belonging to the company in June, 1908, what profit was made upon those parcels. We do not keep anywhere an account with the separate parcels to compare the cost as charged into this inventory book with what we got off from them.

The statements which I gave of the number of thousand feet per acre cut off of the timber lands for the different years average about 15,000 feet per acre for these four years. The most of it was hard wood and hemlock. A very little in each year was pine. At $2.25 a thousand feet this average of $15,000 per acre would be $33.75 an acre for the stumpage. None of this land was inventoried in this book of timber lands or valued as high as that amount per acre. They run from about $2.00 an acre up. There was one parcel in the town of Orange valued at $22.25 per acre. With that exception the highest is $22.25 per acre. That portion of the inventory book

59 which shows the inventory of the timber lands of the com-

pany when organized is offered and received in evidence and not marked.

The Court. No, it is identified. It will be received.

Q. Then it is true, is it not, that as a matter of fact you now know, making a comparison with that inventory that $2.25 a thousand stumpage, at the average rate of cut from 1909 to 1912, fifteen thousand feet per acre, represents an actual profit for the stumpage upon the original inventory cost at which it was charged to the company; that is clear, is it not?

A. Yes, sir.

Q. But as to cedar and wood timber no charge whatever was made upon the books of the company?

A. No, sir.

Q. And in the return that was treated as income, and also the same account was treated as depreciation?

A. Yes, sir.

The Court. That does not exactly apply to the wood.

Mr. Waer. I was about to say that.

Mr. Walker. I understand it does—no, that is true as to—it does with this exception; that upon the books of the company they charged it in at 25 cents a word, is that right, on the books of the company?

The Witness. No, sir.

Q. That is in the return?

A. That applies to the stumpage only, 25 cents. The 25 cents is taken out of the return and does not appear in any way on the books of the company.

The Court. So far as the cedar is concerned the entire profit of the transaction, operating and otherwise, is charged to income and then deducted. So far as the wood is concerned only 25 cents is deducted, whereas the profit was something over a dollar, according to the statement of counsel, $1.25.

The profit on the wood timber account according to our books was for the calendar year 1909, $15,380.33; for 1910, $12,781.58; for 1911, $737.06. These are the net profit after deducting all charges. For 1912 there was a loss in the account of $8,165.22. This would leave the net gain for the four years about $19,000.

In 1912 we got out about 21,819 cords, on which we suffered this loss of $8,165.22. We deducted the entire cost from our operating expenses. We took the entire proceeds for the sales of the wood, credited that to the account, and then charged against the account the cost of getting it out and of manufacturing it.

60 This exceed the amount received for 1912 by something over $8,000.00 and in making our returns for that year we deducted this loss of $8,165.00 and in addition to that on the same account we deducted for depreciation 25 cents a cord. We take an annual inventory. In 1909, at the end of the fiscal year in taking that inventory no one put an estimate upon the stumpage value of the timber and the value of the wood and so on. These prices are the same

as are in that inventory book. The parcels that are not cut off have remained the same from 1908. Those that have been cut off and not sold figured at $2.00 an acre. These were arbitrary prices so far as I know.

Q. Is there any way in which you, as a bookkeeper, can take the books of the Mitchell Brothers Company for these years 1909, 1910, 1911, and 1912 and take this return made for those years and check the return up from the books of the company so as to know whether it is correct or incorrect according to the books of the company?

A. Yes, sir.

Q. How?

A. I have it all written off for one year.

Q. That would not be so as to the estimated value of this timber?

A. No, sir.

Q. With that exception it could be done?

A. Yes, sir.

Redirect examination by Mr. Morris:

As to the sale of this chemical wood there is a contract between the chemical company and the plaintiff and the price is according to a sliding scale. When made it was $3.00 a cord, but it has been reduced since that time and at present is $2.40. In 1911 there was some of this wood destroyed by fire. I do not know the amount.

Recross examination by Mr. Walker:

I cannot say why the price of the wood timber was reduced from $3.00 to $2.40. I don't know whether it was because wood timber had depreciated in value or not.

John Pfeifler, being produced and sworn as a witness on the part of the plaintiff, examined by Mr. Waer, testified in substance as follows:

I reside at Edmore. My principal business is lumbering of all kinds. We (Pfeifler & Bertsch) handle a good deal of cedar.
61 We commenced about 1890 and are a present engaged in that business and have been since 1890. I remember one year we took out 33 million shingles, 25 thousand poles, and I don't remember how many ties. We were in the hole that year. In the past two years we have taken out ten or twelve million shingles, perhaps 18,000 ties. During the past ten years I have tried to keep in touch with the market value of cedar products and have been familiar with the stumpage value of cedar timber.

Q. "Have you, in your cedar operations, purchased any cedar up near Kalkaska or Missaukee Counties?

A. In Charlevoix and Emmet Counties.

Q. Are you familiar at all with the location of Mitchell Brothers' timber in Kalkaska and Missaukee Counties?

A. Not particularly; no, sir."

I have been along by that timber, but not to know anything about it. The plat (Plaintiff's Exhibit 28) shown witness as a general representation of the different properties of the plaintiff.

Q. "Now, assuming that cedar timber is located on section 23 and section 1 of township 26 north, range 7 west, the middle township at the top, could you give what, in your opinion, would be a fair market value of cedar stumpage on January 1st, 1909? First start on these lands that are marked here. Assuming that there was cedar on those lands or that cedar had been taken therefrom, could you give in your estimate the fair market value of those products on the stump on January 1, 1909?

A. I think I could give it to you pretty close.

Q. Assuming that the products to which I shall now call your attention to were located upon those sections of that township on January 1, 1909, what would you say as to the fair market value on the stump at that time—the first item being fence posts three and one-half inches and up at the top?

A. Now, since I was acquainted with what I come here for——

Mr. Walker. I am going to object to the testimony, as the witness is not shown to be competent or acquainted with the land or the timber.

The Court. I think I will take the proof."

(To which ruling defendant's counsel then and there duly excepted.)

Q. "You may finish your answer.

A. I was going to say, since I knew what I was coming here for, I kind of—Mr. Bertsch came down to our office there and I put
62 the matter up to him and we made up a little schedule, looked over our matters and made up a little schedule as to prices we had established, and we were figuring in that way.

Q. You may refer to your list if it refreshes your recollection.

Mr. Walker. Who is Mr. Bertsch?

Q. Who is Mr. Bertsch?

A. My partner.

Mr. Walker. Is he here?

The Witness. No.

Mr. Walker. Now, I object to it, being the opinion of another party than the witnesses.

Q. The figures that you have upon that list, are those the opinion which you have as to the value of the various products?

A. These prices are made on a fairly advantageous job of lumbering. Of course, the value is established somewhat by the character of the ground and what it costs to take it out.

Q. I am asking you now whether or not those figures are your opinion of what that would be fairly worth?

A. Yes, sir.

The Court. I suppose the price would depend something upon the character of the timber, wouldn't it?

A. Somewhat; yes, sir.

The Court. Whether it is scattered or whether it is thick; whether it is in a swamp so deep that you can't get at it; or whether it is fairly accessible?

A. That applies to most anything.

The Court. I supposed it did.

Mr. Weer. I might say to the court Mr. Pfeifler wished to get away to-day, and we can establish that particular point later, if counsel will permit, as to the accessibility.

Q. Assuming this cedar was easily accessible to market and easy to get at, as the average piece of timber, what would you say as to the prices of these products—as to the fair market value on January 1, 1909, for fence posts three and one-half inches and up at the top?

Mr. Walker. I think I will renew my objection.

The Court. I will take the proof for what it is worth."

(To which ruling of the court defendant's counsel then and there excepted.)

A. "Three cents."

I would say the fair market value on the stump of 16-inch shingles was 25 cents per thousand for the extras and clear butts, noth-
63 ing for the third grade; 6-inch and 8-inch railroad ties stumpage, January 1, 1909, 15 cents; 4-foot pulp-wood stump, same date, 75 cts.; 20-ft. cedar poles, 5-inch top, 15 cts.; 25-ft. 4-inch top poles, 15 cts. to 25 cts.; 5 inch, 35 cts.; 25 ft. 6 inch, 65 cts.; 25 ft. 7 inches, 80 cts.; 30 ft. 5 inches, 70 cts.; 30 ft. 6 inches, 80 cts.; 30 ft. 7 inches, $1.70; 35 ft. 7 inches, $2.35; 40 ft. 6 inches, $2.40; 40 ft. 7 inches, $3.75; 45 feet 6 inches, $3.80; 45 ft. 7 inches, $4.95; 50 ft. 7 inches, $8.00.

Cross-examination by Mr. Walker:

I was never on these lands. I don't know whether the timber is thick or scattering. Whether a bad swamp or good hauling, 20 foot cedar poles, 5 inch top, f. o. b. Wabmeme, about 40 miles above Kalkaska, we got 30 cents in 1909. I would not want to haul them several miles and load them for 15 cents. We would lose money at that rate. We would have to cut some of the larger sizes and better grades to make money. As the size of the pole increases the number diminishes. We don't often get 50 ft. poles 7 inch top in Michigan cedar.

"The Court. If you had 40 acres of cedar, how would you estimate its value standing?"

Cedar is a bad one. Most of the cedar that we ever bought we looked the land over. We see how it stands, whether in bunches, and we determine by our past experience in taking out cedar, what we can pay for it. We offer the amount. If he takes it, all right. If he don't want to take it we don't want it. Then again, we have an estimator that was very accurate in estimating cedar. He would go through a 40 and he would determine about how many poles of the valuable lengths the 40 would cut, and how many cords of shingle bolts and about how many ties we would get off there and then figure up what they were worth on the stump and determine the value that way. We estimate it practically by the piece. Cedar is a very tapering timber. It is almost impossible to determine it in board feet, so we have to take it by the piece; poles, ties, and posts are always by

the piece. It varies in qualities just like other timber. Some rotten, more so than other timber. Some of it is streaky. You will find some pieces that you would not think would open up at all and you would be surprised, it will open up nicely; others that you think will open up good you will find it all pencil rot and very defective. There is much waste in working it up. The usual way of estimating the value of cedar timber is by the piece. You carry what you have in your mind for a year or two, you see the character of the ground. It is always a little thicker and better nearer a stream than back and we kind of put one against the other to form our value. We buy some cedar to be paid for according to the product received. So much for different sizes of posts; so much for a tie. Valuable lengths in cedar 35 ft. 7 inch top.

64

When I said we were in the hole I meant we were in deep and had to keep pretty close track of it. We didn't lose, we made some money. That was in 1902 and 1903. Our profits varied on the different tracts.

Darwin B. Kelly, being produced and sworn as a witness on the part of the plaintiff, examined by Mr. Waer, testified in substance as follows:

I reside at Cadillac. Am in the furniture business. The last six months have been in the broom handle business at Lucas. Am connected with the St. John Table Company and the Cadillac Chair Company. I have been buying and manufacturing hard wood for about 30 or 35 years. Our broom handle business uses about a million and a half or two million feet. This was at Lucas.

I have purchased standing timber as a part of my lumber operations and think I have been familiar with the market value of standing timber during the last ten years. I was in the lumber business during the winter of 1908 and 1909 and think I can remember back that far the market value of stumpage in and around Cadillac.

Q. "Are you familiar in a general way with Mitchell Brothers Company's timber lands?

A. "In a general way."

I have been through parcels of it. I don't remember now the descriptions but I have seen it in various ways, one time I bought some logs almost along their right of way. Some of it was accessible to market. Some of it was not until they built their railroad. I do not remember when that was. It has been going along from year to year as far back as I can remember.

In my opinion the fair market value of the stumpage situated similar to that of Mitchell Bros. Company January, 1909, was $4.00 or $5.00 per thousand. For hard wood like the kind I use, mostly maple.

Q. What in your opinion was the fair market value of mixed hard wood timber similar to that owned by Mitchell Brothers Company on January 1, 1909?

Mr. Walker. Objected to as incompetent and immaterial. It is not shown that the witness is competent.

The Court. You may answer.

65 (To which ruling of the court, counsel for defendant then and there duly excepted.)

Q. What in your opinion was the fair market value of mixed hardwood stumpage per thousand, January 1, 1909?

A. I still say from four to five dollars a thousand."

I base that upon the price I paid, I imagine about that time. I can remember one main tract that I bought in 1907, about eight or nine miles south and east from Cadillac in Missaukee County. That was the last purchase I made and was in March, 1907. I did not buy any stumpage during the years 1908 and 1909. There wasn't any more in the market there.

Alfred W. Newark, being produced and sworn as a witness on the part of the plaintiffs, examined by Mr. Waer, testified in substance as follows:

I reside in Cadillac and am a manufacturer of lumber and broom handles and connected with the Cadillac Handle Company. Have been something over eleven years. The company's annual consumption of timber is from eight to ten million per annum. I am familiar with the market value of mixed hardwood and hemlock stumpage during the past ten years and was familiar with its market value on January 1, 1909. I am not familiar with the location of plaintiff's timber in Missaukee and Kalkaska Counties; that is, have never been over that timber. I know where it is on the map. I have no personal knowledge of its accessibility but in a general way I know something about the distance they have to haul it.

I have an opinion of the market value of their timber on January 1, 1909. My judgment of ash value at that time was $10.00 a thousand standing in the woods; basswood the same; elm the same; beech, $2.50 and $3.00; birch, $5.00 to $6.00; cherry I have no knowledge; hemlock, $2.50 to $3.00; maple, $4.00 to $5.00. I have no knowledge of oak or pine.

Q. "What in your opinion was the fair market value of mixed hardwood timber stumpage situated similar to that of Mitchell Bros. Company on January 1, 1909; that is, what would be the fair market average value per thousand mixed hardwood and hemlock timber?

Mr. Walker. I object to that as mere guesswork, because the question does not indicate how mixed, in what proportions; here is a great varying tract.

The Court. I suppose like that of Mitchell Bros. Company.

66 Mr. Waer. Yes; hardwood similar to that of Mitchell Bros. Company.

Mr. Walker. I object to it then because he is not shown to be competent or to have knowledge.

The Court. I think you may answer.

A. Why, my judgment of the value of the ordinary mixed hardwoods, interspersed perhaps with a small percentage of hemlock—when I say small percentage, I mean ten to fifteen per cent—would be from $4.60 to $4.90 per thousand feet, an average."

I have had experience in dealing in wood timber while in Cadillac. I know the market value of wood timber stumpage at Cadillac on January 1, 1909. We had timber taken out after the logs had been taken out which we sold at 25 cents a cord stumpage on the land—buyer cut it. That was about 1909 and 1908. In my opinion, that was its fair market value.

Cross-examination by Mr. Walker:

If this mixed timber was about 50% hemlock instead of 10% to 15%, according to my figures it would be worth about $3.50 per thousand. In giving the price I did, I figured the proportion of hemlock from our own operations on our own land in Wexford and Emmet Counties. I never went over Mitchell Brothers' land to make any estimate of the different kinds of timber or to compare it with costs. Our lands are very largely hardwood, chiefly maple, with some of the other kinds of timber upon which I put a price. A haul of 3½ or 4 to 12 miles, sometimes good, sometimes not, some of it is a railroad, and some by teams. My estimate is given within our own experience. I would say that as a whole the price of hardwood timber stumpage was higher on January, 1913, than on the 1st day of January, 1909.

Redirect examination by Mr. Norris:

I would say that the value of hardwood timber or any timber is contingent upon the quality of that timber, and the place where situated—that is, the expense of getting it out. I do not think its value is based somewhat upon the fact that it is getting scarcer all the time; that is, not to the extent that that statement might be made, I don't think so, not wholly.

Recross examination by Mr. Walker:

Timber is getting scarcer. Those kinds of hardwood we are talking about are getting scarcer, but there is an oversupply
67 to-day. The quality remaining is diminishing, the uses have diminished, substitute woods, woods coming in from the South. Not maple extensively, elm and a lot of beech from Indiana.

Joseph Murphy, being produced and sworn as a witness on the part of the plaintiff, examined by Mr. Waer, testified in substance as follows:

I reside at Cadillac. My business is that of a lumber manufacturer with Murphy & Diggins. I have been for over eighteen years, I think, in the same business. The annual output of timber consumed is about seven million.

In a general way I know the location of plaintiff's timber in Missaukee and Kalkaska Counties. I have seen some of their timber. I have seen a great many of their logs. I have been at their mill, and seen the quantity of their timber. It is fair average for that part of the country. Its accessibility to market is good and facilities with which it can be logged about the average. I am familiar with the market prices of stumpage in the years 1908 and 1909. I don't know that we bought any standing timber during those years, but we bought logs. I would think a fair market value of timber

stumpage situated similar to that of plaintiff on January 1, 1909, was $6 to $7. We cut on our own lands and we cut wood timber and sell it to the chemical company. In my opinion the fair market value of the wood in the tree at Cadillac or wood situated similarly to plaintiff's January 1, 1909, was 40 to 50 cents per cord.

Cross-examination by Mr. Walker:

This wood timber that we got out in the load is 4 ft. wood cut from the tops and the small timber that is not suitable for use as logs. A cord is as it measures up after it is cut. That is the way we get paid for it. That year we are loading this wood on our sidings on the Ann Arbor road, twelve miles from Cadillac, and Cummer & Diggins bought it in 1909 and we delivered the wood on board the cars at the siding for $2.25. The same people are buying it today. They are paying us more for it now. We had it cut by the cord and we made money on our wood timber every year. Got that much out of it rather than leave it on the ground.

L. T. M. Foster, a witness previously sworn for the plaintiff, recalled for cross-examination by Mr. Walker:

68 The statement which I produced previously of the number of thousand feet cut per acre on our timber lands, does not show how much was soft wood or hard wood. We would have to take the total production for the year and estimate from that.

Q. "One thing more. In checking up the inventory books showing timber lands inventoried in June, 1909, as the property of the new corporation with defendant's Exhibit A, your compilation of the lands sold in 1909, 1910, 1911, and 1912, we find that some of the descriptions of land sold on this Ex. A are not found upon the inventory book as on hand or turned in to the new company in 1903. What is the explanation of that?

A. There may have been lands purchased between 1903 and 1909.

Q. No other explanation of it that you know of?

A. No, sir."

I have not the record here of lands purchased between 1903 and 1909, and there is nothing here from which we could tell how much such lands cost per acre.

Redirect examination by Mr. Norris:

Witness identifies wood timber contract to which he referred before.

Contract offered and received in evidence without objection, and marked "Plaintiff's Exhibit 54."

This wood timber was sold to the Jennings plant of the Cadillac Chemical Co., delivered dry and no credit was made by us to the chemical wood account until the company actually took possession, and if the wood burned in the woods no credit would appear on the chemical wood account for that wood.

Recross examination by Mr. Walker:

Q. "Just one question to make plain what I suppose is plain, but I am not sure. Upon the books of the company was there any charge

of this 25 cents a cord that you deduct as depreciation from the returns later on?

A. No, sir."

Bruce Green, being produced and sworn as a witness on the part of the plaintiff, examined by Mr. Waer, testified in substance as follows:

I reside in Cadillac and have for thirteen years been engaged in the manufacture of lumber and shoe lasts. Prior to that, I was agent for the G. R. & I. at Manton, and sold their railroad lands in that vicinity and in that connection, used to look up other lands and help make estimates of timber, and I have had experience since
60 1890 in estimating timber and been at it practically all of the time.

My familiarity with plaintiff's timber in Kalkaska and Missaukee counties is "in a general way looking at timber, and I have been hunting and fishing that took me through the locality of their lands to quite an extent, through the northern and central part of them, east from Manton, and in the south part from Lake City. Since going in with Williams Bros. Company, we own some timber land adjacent to theirs east of Manton and east of Fife Lake. In looking after this it took me there and I have been in both those localities helping estimate timber for other people."

I think the general lay of the land is very favorable for logging, if anything, better than in some adjoining counties. Mitchell Bros. lands are equally good and better located for operating than the lands in which I have been interested; they are very well located. They are tributary to three railroads, the Pere Marquette, the M. & N. E., and the Lake City Branch of the G. R. & I. As to the quality of their timber, "what I have seen of it in the standing timber, and I have also seen their logs at the mill, some of them in the decks in the woods, and I have seen their lumber piled in the yard, and I consider it a very good grade of timber, a good quality."

In the past ten years through my connection with William Brothers' Company, I have been familiar with the market value of timber stumpage similar to that of the plaintiff. I have had to do with the estimating and buying of their timber. The price has advanced on an average of 10% between 1908 and 1909. I mean 10% each year compounded. Those figures are in accordance with our actual transactions in our deals for lumber. In my opinion $6.00 per thousand is a fair market value of maple stumpage situated similar to that of plaintiff's on January 1, 1909; of elm $10.00, beech $4.00, hemlock $4.50, basswood $10.00, birch $7.00, and the fair value of the average stumpage January 1, 1909, situated similarly to that of plaintiff's was $6.00 per thousand. I would consider 25 cents a cord a fair market value of wood timber stumpage January 1, 1909, like that of plaintiff's. I base that from our sales. We sold it 25 cents a cord from 1908 to 1912. Since then we have been getting an advance.

Cross-examination by Mr. Walker:

When I say $6.00 a thousand for the average value of timber
70 like that of plaintiff's, I do not know as I could tell you the

percentage that I figured to be maple. I never made any figures on the value of plaintiff's timber to go over what proportion of it is maple. I arrived at those values by making comparisons with timbers that we had handled. I would think there was 30% maple. That is an off-hand estimate that I had not before attempted. I would say 15% is beech, 7% basswood, 13% elm, 25% hemlock, 5% birch. About 2% ash and about 2% sofy maple and 1% cherry.

I never went over these timber lands of plaintiff's to estimate them. I have been past and over their lands and on lands adjacent to theirs in making estimates of other timber. Passed the lands on the highway, sometimes across the lands through the woods. That was when I was hunting and fishing, but one is interested in timber no matter where he is. If he sees a piece of timber he looks at it.

That 10% annual increase in the value of timber stumpage continued from 1902 up to and including 1912.

J. J. Wood, being produced and sworn as a witness on the part of the plaintiff, examined by Mr. Norris, testified in substance as follows:

I live in Grand Rapids. Am in the real estate business and have been for about 15 years and think I am familiar with real estate values in Grand Rapids. I remember four or five years ago disposing of some property on Kellogg & Bemis addition for the plaintiff. In my opinion, the fair market value of that property December 31, 1908, was $900.00.

Cross-examination by Mr. Walker:

I sold it in May or June following for $1,000.00. I think I got what it was worth.

Redirect examination by Mr. Norris:

Plaintiff did not get that $1,000.00 by a considerable. There was some net price made to some real estate men, including myself, and we sold it for more than they got. It was a speculative deal in the end, so there were some things entered into it that was not fair for them to expect to receive money for. I did not sell it for actual cash. There was a real estate promoting scheme that had a certain intrinsic value to it that these people were willing to pay for. They paid a thousand dollars for the land and other considerations. The net price plaintiff made on the property was $750.00, I think. We might have what we could make over that. This price was made four or five months before the sale.

71

John Caldwell, being produced and sworn as a witness on the part of the plaintiff, examined by Mr. Norris, and testified in substance as follows:

I live in the village of Manton, Michigan. Formerly lived in township 23 north, range 8 west, section 4, and Mitchell Brothers' operations were surrounding this, from there east. I lived on the northwest quarter, section 4—went there in 1869. Was farming at first, since 1892 have been looking at timber and buy and selling timber. I have been over every 40 that Mitchell Brothers own in that vicinity. First, with the idea of determining the amount of timber;

after that I sold the stump lands. I began to sell the stump lands in 1892, I guess. These pine stump lands in 22–8 and 23–8 along this logging railroad are not of much value. The lands in 24–8 on the east side are hardwood timberlands on the south, but the bottom lands of the Manistee River are pine or jack pine. The hardwood lands in the south half *half* of 24–8 are settled here and there and they have mostly highways laid out on section lines, except right in the southwest corner of the township. In the north half of the township are pine stumps or jack pine plain lands. In township 25 north, range 7 west, the north half and the east half are hardwood lands; the south and southeast are pine stump lands or jack pine, thickly settled by farmers that have been in there from 1870 up to the present time; highways on most all section lines."

I think I know the fair market value of the stump lands of Mitchell Bros. since I have been dealing with them. As near as I can remember I don't think there has been any change as to the value of these lands from 1905 to 1912. We are offering them at about the same price. That is, first-class hardwood land, and the price I got in 1908 for lands sold was about the same as in 1909, 1910, 1911, and 1912. "The lands in 24 north, range 7 west, in Pioneer Township are located about 15 miles from a railroad, and we commenced selling those lands from this to seven dollars an acre, and we are still selling them—well, I sold some within a month for eight dollars an acre; that is the highest.

Township 35 north, range 7 west, and 26 north, range 7 west, are accessible to market and railroad, and those lands have been spoken for for fifteen years—that is by farmers that lived adjacent to them and wanted the option, and we figured those lands were worth more than the land in the other township, because they sold at the highest price that I remember selling land for, at $22.00 an acre; that was right at the station, from there out. I could have sold those lands any time within the last ten years for the same price, but we would not sell them on account of the timber was not cut on the lands and we did not want to sell ahead of the operations for fear we would get into trouble, but as soon as the lands were cut over those parties took the lands at the other prices, and I considered that they were worth that much more on account of location than they were in the other township, 24–7, not any better soil or better lands at all, but the difference as to market and location."

72

Cross-examination by Mr. Walker:

I generally went over these lands and put a price on them for the purposes of sale. I put that price on in 1911 and 1912; that is, I had an advertisement made up with a price list for each description. I think I began to put that price on them for $6 to $7 per acre on 24–7 about 1902, and prices on the same lands were about the same on account of the location, except the one parcel I sold within a month at $8 an acre. The low prices on the lands on 24–7 was

because of distance from railroad and highway. In selling these lands in 25-7 and 26-7 to the people who wanted them previously, in a way I got a fair price. I was doing business for Mitchell Bros., but I was disposed to do business as to about what the land was actually worth after the improvements were put on them. I think they commenced lumbering these lands on 24-6 and 24-7 about 1896, and they had some timberlands for sale on 25-7 and 26-7 in 1905 or 1906. I think I sold those for $12 an acre within half to three-quarters of a mile to a railroad station. I sold some for $15 and some for $12 an acre.

Charles T. Mitchell, being sworn as a witness on behalf of the plaintiff, examined by Mr. Norris, and testified in substance as follows:

I live at Cadillac, have since 1880. I know the plaintiff company, have since its organization. I am the son of W. W. Mitchell of the old firm of Mitchell Bros. Austin Mitchell, the other member, was my uncle. I am 34 years old. I have been in the lumber business since 1898, near Wolverine, in Cheboygan County, from 1899 to 1906; I came with plaintiff company; I became director and vice-president in September, 1906, and secretary and general manager in September, 1909.

73 I am familiar with the location of the land of plaintiff in Missaukee and Kalkaska Counties. I have been on all of them. Have had to do with the plans of them, of logging railroads and such things, since 1906. They are mixed hardwood lands. I could not give you the year when those lands were first acquired by Mitchell Bros. I have known my father having an interest in them since 1897 or 1898, some of them were owned prior to that. I have known of them ever since my connection with the plaintiff.

"The original stockholders of the plaintiff company were W. W. Mitchell, Cobbs & Mitchell, Incorporated; Mr. Edward Fitzgerald, of Grand Rapids; Mr. Spaulding, of Cadillac, and Dr. W. H. Sawyer, of Hillsdale, and Mrs. Dr. W. H. Sawyer, of Hillsdale."

Mitchell Bros. Company bought out Mitchell Brothers and formed a stock company, of which these people became stockholders.

Q. Now at the time that you first commenced your connection with Mitchell Brothers what, if anything, did you have to do with making up a schedule of approximate prices for stump lands of the company?

A. The first year, 1906, I spent most of my time in connection with the timber and lumbering part of the concern and at that time went over the stump land situation with Mr. John Caldwell, who had the sale of them, and agreed with him that he could sell the land at certain prices. Those prices have never been changed since.

Mr. Walker. That was 1906, you said?

The Witness. Yes, sir.

Q. Has there been any change in the valuations of the lands of Mitchell Brothers made on their books since the organization of the company, so far as you know?

A. No, sir.

The Court. How did the prices which you fixed on the lands compare with the actual prices which were obtained later?

A. Just about the same, possibly a little bit less. Of course, my object was to try and make Mr. Caldwell sell them for as much as possible.

The Court. You mean that you fixed prices that were higher than what he actually sold for?

A. Yes, if there was any difference. I don't believe, outside of the land he sold right at the station of McGee on the Manistee and Northeastern, that he ever got more than the prices.

Q. By the prices you mean the prices you fixed in 1906?

74 A. Yes, sir.

Q. Mr. Mitchell, will you explain to the court, as far as you know, how the valuation of $2.25 for hardwood and eight dollars for soft wood, at which you were accustomed to close the books of Mitchell Brothers each year, was arrived at?

A. At the time of the incorporation when the lands were taken over at about twenty dollars an acre, they averaged close to that and was the idea of twenty dollars an acre——

Mr. Walker. I object to that and move to strike it out. There is better evidence as to how much it was taken over at.

The Court. I think that may stand.

Mr. Walker. I think the books show exactly what they were taken over at.

Q. Proceed.

A. We cut at that time seven to eight thousand feet to the acre.

Q. Just explain how you cut that small amount as compared with the larger amount which the evidence shows you cut later.

A. At that time we didn't cut any beech to speak of and only the very best of the maple, and after the chemical business got started and they logged—re-logged the wood logs it increased the amount of saw timber per acre up to the present time and beech became salable and poorer maple.

The Court. In other words, you cut the timber closer?

A. Yes, sir. When that timber was bought it was estimated at about five thousand to the acre and we couldn't make a Michigan lumberman believe it was possible to cut any more than that of hardwood.

Q. Now, go on with the explanation as to how this $2.25 and $8.00 was arrived at.

A. The $2.25 and $8.00, the amount they got per acre, would have wiped out the timber account when they got through. By getting more per acre it has never been changed. W. W. Mitchell, who was president of the firm, used to carry on the same figures that he started with.

Q. What can you say as to whether or not in using that figure in closing the books it was done with any idea that that was the value of the stumpage?

A. No, sir; it has never been changed since that in regard to the value.

Q. Testimony has been given here, Mr. Mitchell, as to the
75 value of the various kinds of stumpage cut in each of the years 1909, 1910, 1911, and 1912 from these lands at which the stumpage was charged back for restoration of capital assets before fixing the net amount of income, which is the measure of the tax in this case. Will you explain to the court how you arrived at those figures?

A. From what information we could obtain at the time of sales that had been made in the lower Peninsula of Michigan, we considered that $5.00, an average of five dollars stumpage would be very easily obtained for our timber, and we worked out these values for each kind of wood to obtain an average of five dollars, which, of course, in fact, has never quite come up to it, but that was the idea."

Before going with Mitchell Bros. I bought and sold timber of a similar character in Kalkaska, Cheyboygan, Wexford, and Milwaukee Counties. In determining the value of the mixed hardwood stumpage the factors that enter into it are what it would cost to log it and get it to the market. "As a whole I believe Mitchell Bros. have the easiest logging proposition of any lumbering concern in the lower peninsula because the ground is not as rough as most hardwood ground." In my judgment $6 or $7 per thousand was a fair value of this stumpage to plaintiffs in December, 1908. "As to the selling proposition, I have always felt it should sell for more money than any other blocks of timber because there were more markets; the Manistee and Northwestern, the Pere Marquette, and the Grand Rapids and Indiana would open up markets on both the east and west sides of the State, and most of the other timber in our locality could only be sold and manufactured on the G. R. & I.

I never had any doubt but that the stumpage of Mitchell Bros. in December, 1908, could be sold for six or seven dollars an acre.

"The Court. I think you misspoke yourself; you meant a thousand.

A. Yes, sir; a thousand. Thank you. B. G. Peters sold some seven thousand acres to the Tearns Salt & Lumber Company about 1906 or 7 in the same locality for—to Buckley & Douglas, for $75 an acre. That was the only other timber that has ever been sold in that locality. Some of it was in 25–7 and some in 26–7, right in the same two towns.

"Mr. Walker. I move to strike it out as incompetent and immaterial.

The Court. It may stand.

Mr. Walker. Note an exception."

76 The character and quality of the timber sold by Peters was just the same as ours; some of it was on the same section and the cut about the same.

Q. "Now, it appears from the evidence here that in keeping your stump land account, you closed your books by charging your cut-over lands into the stump land account at two dollars an acre for the pur-

pose of closing your books. Will you explain how you come to do that?

A. Most of the stump land that was turned over to Mitchell Bros. Company was pine stump land, which they still own, the majority of it being north of Jennings, a very rough country, besides being poor soil. There was some owned on the Manistee plains, which was purchased for the purpose of a right of way. That composed most of the stump land that Mitchell Bros. Company received from Mitchell Bros., and that charge has always staid the same—stump land account. We had to get rid of it, and it was dumped into that account at two dollars an acre.

Q. Was that charge of two dollars an acre made because you thought that was all the land was worth, or for any other reason; if so, state what?

A. Why, in the first place, stump land has not been a very salable thing for lumbermen. We are the only concern in Cadillac that are able to sell any stump land—by any, I mean over forty or eighty acres a year; and the lumbermen generally did not consider it worth much and never thought much of it. It got to be a habit of saying, dump it into that account at two dollars an acre. It always staid there; it has never been changed."

Timber lands in this vicinity of this character, of Mitchell Bros. in 1900, were worth from twelve to eighteen dollars an acre; in 1909 they were being sold from seventy-five to one hundred dollars an acre.

"The Court. As a matter of fact, they were sold on a stumpage basis, on an estimate of the amount of timber they would cut. When you say seventy-five to a hundred dollars an acre, it was based on the amount of timber that would be cut off?

A. Generally spoken of as so much an acre. If you asked anybody how much they would take for their land, they would say so much an acre. In finding out whether you could pay that much an acre, you based it on the stumpage value. The Ward tract, which was the one large tract of timber sold in the southern peninsula, was all sold by the acre.

Mr. Walker. I suppose they made an estimate of it before they bought it.

77 A. Yes sir."

Regarding firewood, I have had the actual getting out of the wood. As to disposing of it, of course, we had a contract with the Cadillac Chemical Company, which took care of that. Since we have gotten out wood we have lost from twelve to fifteen thousand cords by fire. We lost eight thousand cords at one time. I think it was in 1911. The loss occurred in the woods. In December, 1908, 25 cents a cord was a fair value in the stump before it was cut up. We paid that much if we bought it from anybody. We bought some during those years.

Square timber is sold on the stump. The firm buying go there and hew out a tree here and there all over; there are no roads to it and they have to take it out by wagon over the ordinary country road to their nearest point of shipment. On account of our timber being so close to the Pere Marquette, and the square timber being loaded on boats at Traverse City, we were able to get a better price for the square timber than ordinarily, where they would have to haul it ten to fifteen miles over hills and through sand. All of this timber was of within six miles of a railroad; most of it nearer, a mile or two.

The Court. As a matter of fact that is the best timber that you have, isn't it?

A. No, haven't only a little of it.

The Court. I mean it is the best timber on the tract?

A. Rock elm; yes, sir.

The Court. It is the best timber of its kind, too, isn't it?

A. Yes, sir.

The Court. That that will make those square sticks?

A. Yes, sir."

To the Court: In this particular case I don't think taking this out depreciated the value of other timber much.

If you would go in where there was a bunch of pine, because that would all stand together generally; rock elm is only a tree or so on a section. We always figure it is a detriment to allow anybody to go in there to cut it because of their leaving tops and chips.

"The Court. Making it dangerous for fire?"

If you scale the logs for yourself—that is, put it in the saw mill—you will get more out of it in feet, because they don't take the top, which sometimes has a good log in it. We could have got the same price for it as for square timber in December, 1908, at any time along there for five or six years anyway, because I had square timber
78 men seeing me three or four times a year to buy it, and I always refused to sell it until we got into that locality a little bit ourselves, so we could keep track of them. The question of roads and closeness to the railroads is what sold the timber at the price it did. Kalkaska County, I think, has the best roads of any county around us and we have State award roads through our timber there. The rock elm is all taken from Kalkaska County.

To the Court: This square was mainly elm.

To Mr. Norris: I think a few feet of pine.

Q. In this chemical wood account I notice—it has been testified here by Mr. Foster as to the account showing a loss for the year 1911. Have you any knowledge as to any difference in inventory price on the wood that you had on hand of that year as compared with the previous year?

In 1910 the chemical wood was inventoried at three dollars a cord. In 1911 it was inventoried at $2.63, based on the difference in price received from the chemical company. In order to comply with our contract with the chemical company we have to carry a

stock of from 35 thousand to 40 thousand cords, for the reason that the wood is not in condition for the chemical company until it is about a year and a half old. For the purpose of drying it.

The cedar that we sold is located on section 23 and section 1 of 26-7. It was within half a mile of the Pere Marquette Railroad. It was an average quality of cedar for the lower peninsula of Michigan.

Cross-examination by Mr. Walker:

I don't know that I have any book or articles of association that shows what the original capital stock of the company was when organized. I know what the original capital was. It was capitalized as paid in one million dollars. I suppose that included these inventoried timber lands shown on the inventory book at the price there shown; that is, that was treated as so much paid in by W. W. Mitchell and those interested in the estate of Austin Mitchell, composing Mitchell Bros.

Q. "And was computed toward the paid in capital stock and paid up stock was issued to the parties having the right thereto, wasn't there?

A. The estate of Austin Mitchell was paid cash; they were never a stockholder."

That means other stockholders—that other people, either as original subecribers or purchasers of stock, paid in cash to some extent
79 by which the estate of Austin Mitchell was bought out, and they took stock for what they paid in.

The paid-up capital stock on December 31st, 1908, was one million dollars, December 31, 1912, the same. It has declared dividends from year to year in 1909, 1910, 1911, and 1912. I couldn't state such dividends for those years.

"Mr. Walker. Have you that (the record)?

Mr. Morris. You might ask Mr. Foster. Have you the book that shows the dividends declared?

Mr. Foster. I can take it from the ledger.

Mr. Walker. Suppose you take the ledger and find out."

The full amount of profits for those years were not declared in dividends. Timber was purchased with the balance of profits not paid out in declared dividends for those years. They remained in the company and were carried to surplus. These lands bought were not used in the business; that is, not in this locality. They were bought for the corporation. They were bought and paid for out of surplus. The amount thus paid continued as surplus in the final statement, and did not diminish the surplus because the lands took the place of the money. All profits not declared as dividends were carried in surplus account. I could not tell exactly what the surplus account or fund of the company was on the first of January, 1909. Something over a million dollars as near as I can tell you. I think Mr. Foster can find that out probably and not have to guess at it. We never declared a dividend in relation to our year's books. We de-

cleared one whenever we had a surplus of money. But the dividends when they were declared and the surplus when anything was carried to surplus, the two amounts together represented the profits as shown by the books for that year.

"The Court. Do you mean that or do you mean the receipts of money?

The Witness. I don't understand the question.

The Court. I say, do you mean that it all came out of profits or do you mean it was receipts of money?

To the Court. Receipts of money that we declared our dividends on. Of course, one year's statement at the end of the year would show what our profits were, and the dividends, that part of it that did not go into dividends would go to surplus.

Mr. Walker. That is exactly what I mean."

There was no deduction made on our books of $4.33 a
80 thousand or five dollars a thousand or any other sum, for stumpage, as depreciation, but there was charged against our lumbering operations upon our books the sum of $2.25 a thousand stumpage for hard wood and eight dollars for soft wood consumed during the year—manufactured. If they get back the surplus they had at the beginning of the year 1909 on December 31, 1908, of a million or more, it will more than make good all of the original investment of the corporation as represented by its paid-up capital. They are supposed to have the assets at book value to show for that capital and surplus, and in addition, the assets, so far as stump land and stumpage is concerned, exceeds the book value. All items of assets should exceed the book value of the same item unless it be current accounts. We depreciate our accounts and charge them off—our bad accounts. We do pretty nearly a cash business and don't have accounts of actual value to keep up to their book or face value. I don't think there were hardly any dividends declared from 1903 up to 1909 the first of January. I think we began to declare dividends about 1906 or 7, and all earnings up to that time went into surplus. I imagine it is a fact that we did not begin to declare dividends until we had a surplus of a million dollars or thereabouts, and all the time thereafter we kept our million dollar surplus good. It has been growing since that.

I can't state from my knowledge who put the price upon these timber lands turned in to Mitchell Bros. Company upon this inventory book, but I expect Mr. Edward Fitzgerald, who was with Mitchell Bros. as general manager before the organization of Mitchell Bros. Company, and W. W. Mitchell. I think Judge Denison represented the Austin Mitchell estate in that valuation. Judge Denison was one of the administrators with Mrs. Austin Mitchell and they were interested, of course, in having a fair cash value put upon those timber lands at that time as long as they were to get cash for their interests. That was the purpose and intent so far as I know to put a fair cash value upon these timber lands. This $2.25 a thousand book charge for stumpage, hard wood, and eight dollars for soft-wood

stumpage was fixed and began to be made at the time of the incorporation of Mitchell Brothers Company. I had something to do with it personally. I think the same people that put the valuation upon these timber lands arrived at that figure also and that was on the basis of seven or eight thousand per acre, which in the proportions, as they figured them, would run hardwood and soft wood, at those prices, $2.25 and $8.00—would pay an average purchase price of $20.00 an acre for the timber land. I think the books show that those timber lands as inventoried in 1903 and turned in to Mitchell Bros. Company averaged nineteen dollars and some cents per acre. I think it shows on the inventory book. I am not familiar with the books, but Mr. Foster can show you. I understand that this land that is carried there at $2.00 an acre, on the inventory book. It is not timber land; it is pine-stump land. I think all the $2.00 an acre land there was inventoried stump land. It would be considered stump land at that time. You might possibly by the change in conditions, and often the line was not run right, get off a little from one price, but it was all supposed to be stump land.

81

Q. "Anything that is inventoried there above two dollars an acre is some kind of timber land, is that right? Some, for instance, at three and a half, $3.75, was that timber land?

A. There might be some piece of stump land that had a building on when it was purchased as timber land, there was a house on one corner of it, something of that kind, that would make a little difference."

I don't know what the lowest price put upon actual timber land was, or is, or where the dividing line is drawn between timber land and that which was not. This attempt of mine made in the forepart of 1910 to estimate the then stumpage value of our timber lands, which I intended to figure at about five dollars a thousand, was made solely for the purpose of making returns to the Government, tax returns, then and thereafter. It wasn't taken by any estimate which anyone then made going over the lands, viewing the timber, and putting a price on it. It was taken from what is actually cut off, from whatever lands were lumbered during the year, on the basis of a certain price per thousand for the different kinds of timber, without reference to the quality other than it was elm or beech or birch or some other variety of hardwood or softwood. The market value of manufactured lumber, hardwood lumber, increased from 1903 to 1909, the first of January. Taking the period as a whole there would be an increase. The increase differed on different woods at all times; sometimes one wood is up and another down, on account of the supply and demand. That does not affect the stumpage value of Michigan hardwood; it never has. If we get less for it manufactured we won't get as much out of our stumpage if we own the stumpage and manufacture it. I don't think if it continued for any length of time it would necessarily affect the stumpage value of that particular variety.

82

Q. "The profit you could make in handling a given variety of wood is one of the principal measures and determining factors in the valuation of the stumpage of that wood, is it not—the timber?

A. There are other lines besides the straight lumber business that you might be able to sell it to and make a profit."

I don't believe you would have to sell it at a less figure; I never knew the stumpage to go down. We would have to sell the manufactured product less, but the stumpage has gone up ever since I have known anything about it. I have never known it to go down from 1903, continuously up to the present time.

The market price of manufactured lumber has been going up and down, both, from 1903 to the present time. I couldn't tell you how much higher it was on January 1, 1909, on an average, what per cent, than it was in June or January, 1903. I have no idea what the total rise was or how far it was offset by a fall during any of those years.

Q. "As a matter of fact, of course, if you estimate it on the basis of seven to eight dollars a thousand stumpage—I should say seven to eight thousand feet of timber per acre to pay for the inventoried price of the timber land, and get from fifteen thousand to seventeen thousand feet per acre, that is what you get, isn't it?

A. Not in the first years of the incorporation.

Q. When did you begin to get that?

A. I think the Chemical Co. was started in——

Q. We are not talking about wood timber; we are talking about lumber.

A. That affected most of the lumber part of it."

We log everything that is eight feet long. We don't sell it to the Chemical Company. When we take it to the mill, if there is a board in it we take it out, if there is only one; the rest goes to wood. I think the Chemical Company started after 1905 or 6. I guess they didn't start before 1907. There has not been a progressive increase in the value of stumpage since that time on account of the Chemical Company's demand; not since they first started. We got just as much the first year as we have since. We got more saw timber. It doubled the output of saw timber and the increased value of beech and
83 maple culls. We sold maple culls in 1900 for $2.75 and since I have been with Mitchell Bros. they have never been less than $8.00, since 1906. I was not with them before in another capacity.

As a matter of fact, with the timber stumpage there on these lands, or proven to be on these lands, the inventory of 1903 turned into the company, figuring it at $2.25 a thousand for hardwood and eight dollars a thousand for soft wood, it a good deal more than pays for the original cost price which was turned in to Mitchell Bros. Company. In 1909 we had taken off from those lands enough stumpage and other products at $2.25 a thousand for hardwood and eight dollars for softwood to pay for those lands at the inventory value We do not count basswood as softwood, only pine. The term "softwood" should be pine. That is the term we have used here. We

don't sell tamarack. We manufactured a little to use on the roadway, on the tramway, because it is not very salable. We put an estimated value upon it in figuring our depreciation in making these returns, $2.00 a thousand. The cedar was not counted in that stumpage, but we made a deduction from our returns for cedar. I don't believe the basis for deduction on cedar was figured out on the different varieties, just merely cedar at whatever it happened to go in. I never knew of its being valued as shingles, poles, or whatever it was cut for when it was bought. That is the way we sell it. We deducted the total amount received for cedar less the cost of manufacturing and hauling, not so much a pole or so much for bolts for a thousand shingles or anything of that kind. I couldn't say if we should figure the value of our wood timber per cord according to what we have actually received for it under the contract made with the chemical company one year with another that it would not amount to 25 cents a cord stumpage for those years beyond question. The only way would be to take the total receipts and losses for those years and figure out the number of cords. That we have done. We did not do that in the year that we figured that we actually made a loss on wood timber but still made a deduction for depreciation from the net return. We figured our value of wood timber per cord 25 cents, just the same. The loss was due that year to the scaling down of the price under the contract made with the chemical company and fire.

We charged a loss on our books for the wood timber destroyed by fire whatever money we had into it. It was in the cord when it was burned and paid for by the company. It cost to cut it and get
84 it in the position it was when it was burned somewhere around a dollar and a half, but it cost a dollar a cord to cut it. It would depend upon how far it was hauled to the railroad track. The fire was in 1911. We didn't have our wood products insured. We have lost wood practically every year so far as that is concerned. I think we figured a deduction on our tax return of 25 cents a cord on the timber that was burned.

To the court: I mean on the wood that was burned. We didn't figure anything on timber that we had manufactured into wood.

The wood timber standing has never been considered in the Government report of our own, not until it became wood. I think we figured a depreciation of 25 cents a cord on the 8,000 cords burned. Mr. Foster can answer that definitely, but that is my recollection. I don't know that I have anything here to show what these timberlands were assessed at per acre before the timber was cut. I am somewhat familiar with it. I have looked over our assessments from year to year or had them looked over. I never looked the tax receipts over personally. I know about what these timber lands are assessed at in Kalkaska County and Missaukee County. I know we have less timber every year and pay more taxes. They average $60 per acre in Kalkaska County. I have been going there since 1906, and they have been raising from $40 an acre since then; they are either $60 or $65, and the whole of Kalkaska County is assessed the same. The

board of supervisors agree what timberland is worth and one town is assessed exactly the same as the other. In 1906 they were $30 or $40; in 1912, $56 to $65. I don't believe I could state what they were in Missaukee county in 1906, because each supervisor assessed every piece different; there was no regular way of getting at it like in Kalkaska County; each piece was assessed separate and different. I have been before the board of review of every township every year since 1906. I never had an assessing officer or board of review ask how many feet I got off the lands and I never heard them ask what the stumpage was valued at, never heard them use the word stumpage.

Redirect examination by Mr. Norris:

At the time of the organization of Mitchell Brothers Company the whole property was taken over and what property they owned in the village of Jennings and some real estate here in Grand Rapids, and logging operations, also.

85 The cedar operation spoken of was the only one that Mitchell Brothers ever conducted so far as I know. In regard to the operating profit in that account, there wasn't anything charged up to the cedar in the way of camps which were used, or logging railroad or the roads that were put through the section for the saw log timber, all of that was absorbed through the saw log timber. We never considered we made anything on that cedar. We had at that time an assistant expert woods superintendent whom we had hired by the year and had to keep him, wanted to keep him because we expected him to take the place of the woods superintendent, which he has since done, and I don't believe we would ever have put that cedar in if we had not been making a place for him, in the first place.

Q. "By the Court: Now, Mr. Mitchell, if I may ask a question that is in a way a summary of this situation. In making your returns to the Government, as I understand it, you deducted from your total net income what you determined to be the market value of the timber as stumpage and separated it into the different varieties at the different prices.

A. Yes, sir." We never changed it since the first. It has been on the same basis. We determined those values as of the beginning of 1909, or the end of 1908. For the wood we pursued the same process estimating that the wood timber was worth 25 cents per cord, and we deducted that sum. We estimated that that was the fair market value of the timber before it was manufactured into wood. When we came to the cedar we pursued a different process; we simply deducted from the total income from the cedar the cost of getting it out and manufacturing it. That deduction was not based in any way upon the value of the cedar, as so much for the different varieties of cedar products. We simply deducted the entire amount which our books showed was a gain over and above the operating expenses. Our books showed a small profit on the cedar, not charged anything up to it, which we should have done by rights if we were in that business; we never considered we made anything on that cedar, we didn't have an income of it and we didn't think we

should pay on it. We did not place any value on the cedar as of the first of January, 1909, and we deduct that amount as we had done with the other timber. So far as the stump lands were concerned we had deducted, not for the return, but so far as our books were concerned, the arbitrary price of two dollars per acre. When
86 we came to make our return relative to the stump lands account, anything derived therefrom we deducted the difference between the two dollars and whatever it was sold for, but on the return we deducted the whole selling price, less cost of selling in the way of commissions whatever it was. We pursued the same plan before 1909 as since. We did not fix any value upon them as of January 1st, 1909, as we had upon the timber. We simply returned as a deduction the whole net amount for which the land sold.

On the office building and lot in Cadillac it was carried on the books at $3,500 and sold at $5,000, and we deducted $1,500, and the same with the Grand Rapids lots. The return on this property was made up in three different ways, one applying to the timber and the wood, another to the cedar and a third to parcels of real estate. The cedar and the stump land would be practically the same.

Mr. Norris: "In principle there is no difference between the city real estate and the other, because they charged off on the books the $3,500, which is part of their capital; simply figured five thousand dollars was the actual value of the property on the first of January, 1909, and it was on the actual value that they got out, in the stumpage and the wood.

The Court. That would also be true of your stump lands, so far as that is concerned.

Mr. Norris. Yes, that is the point.

The Court. But as a matter of fact, notwithstanding that the stump lands have been carried at two dollars per acre on your books, you charged off the entire proceeds.

A. Yes, sir.

Mr. Waer. Not including the two dollars charge.

Mr. Walker. It amounts to a deduction.

Mr. Waer. Less two dollars per acre.

Mr. Walker. The two dollars per acre already appeared as a loss, not as a gain; it did not appear in net income.

Mr. Waer. That is true. The net income of the stump land account was put into the income, and the balance of the stump land account was charged back as depreciation, leaving nothing to account for.

The Court. I think I understand it."

Witness. In regard to the cedar products account, I said there was no operating profit in that account, that what we got out of it was the value of the stumpage as it was in January, 1909, and that was all.

87 Mr. Norris. "It was the only operation that they had ever conducted, and they used a large amount of other facilities, which the witness stated, and I so understood that to be true."

Witness. As regards the stump land we figured its value in 1909, it having been sold on the basis of valuations made and fixed in 1906, we figured that was the value of the stump land on that date. Of course, there are other charges for taxes on it since 1906, when that valuation was put on there, which was wiped out in the business every year, absorbed by the expense account of the business.

To the Court: Whatever the theory is we did not in practice for the purpose of this return, fix a price on our lands as we had upon our stumpage. We returned the entire proceeds from the lands, the net proceeds as a depreciation, upon the theory that the lands had not brought any more than they were worth on the first of January, 1909. As I stated this morning, I think we are the only lumber concern that was able to sell any stumpage in our locality.

Q. "I don't know that I just understand the reason or your theory for charging off fifteen hundred dollars, or for deduction I should say, fifteen hundred dollars, on the office lot in Cadillac, instead of the selling price.

Mr. Waer. Before he answers that may I make a statement with reference to the bookkeeping, which I think I am more familiar with than Mr. Mitchell. The proper way to have entered that on the income tax statement would have been to include five thousand dollars in the income, and, under Mr. Mitchell's theory, charged back five thousand dollars of depreciation. Now in this bookkeeping Mr. Foster did not do that. When he made up his return he included fifteen hundred dollars in income, and then charged back fifteen hundred dollars, the result being the same.

The Court. Of course it doesn't make any difference whether you add a hundred and then subtract one.

Mr. Waer. The same thing is true with reference to the Grand Rapids real estate.

The Court. So far as the return of taxable property is concerned, it is nil either way.

Mr. Waer. That is what I say, it is merely a matter of bookkeeping whether they put in fifteen hundred or five thousand and charge back fifteen hundred or five thousand.

The Court. "I am trying to get at what was done, not what the theory is. With reference to these properties you pursued three methods, those which I have stated."

88 Witness. I said twice, once this afternoon and once this afternoon that our concern is the only one that is able to sell any of these timber lands, which is substantially correct. All I know about the market value of these timber lands is what we are able to sell them for, and have sold them for, from time to time. There has been a market for these that we have sold, a customer usually finds us.

Q. (By the Court.) "You don't mean that because there have been thousands of acres sold in Missaukee, Kalkaska and Wexford counties in the last seven or eight years!

A. Not by the concerns that are lumbering there.

There have been some pine lands, lumbered twenty or twenty-five years ago that have been sold by some land sharks; outside of that there has not been. Cummer & Diggins and Murphy & Diggins have as good lands in Wexford county, and they can't sell them, they don't sell them.

The deposition of Henry Knowlton of Cadillac, Michigan, was offered in evidence by plaintiff and received without objection.

Henry Knowlton, examined by Mr. Waer, testified in substance as follows:

I reside at Cadillac, Michigan, and am at the present time in charge of F. A. Diggins and Carrie E. Diggins estate. I have been engaged in that work since April 1, 1913. Prior to that time I was connected with the Cadillac State Bank in the capacity of cashier from the date of its organization in 1895 to about April 1, 1913, when I became its vice-president. As cashier of the bank I inspected all of the property on which loans were made by the bank, and together with one other officer made the loans. In my experience as cashier of the bank and in the making of loans, I was familiar with real estate values in the city of Cadillac on January 1, 1909, and thereabouts. I know the property known as 122 South Mitchell street in the city of Cadillac occupied for many years by Mitchell Brothers Company as its business office. The property is located next door to the bank, it adjoins the bank on the south. The fair market value of that property on January 1, 1909 was five thousand dollars. In my opinion it was of the same market value during the year 1910, it did not increase in value during the two or three years following January 1, 1909, because Cadillac real estate in general did not increase in value during those years. No new factories
89 had been established and none enlarged that would warrant an increase in the value of property.

Cross-examination by Mr. Walker:

This property was worth three thousand dollars or three thousand five hundred dollars on January 1, 1900, the value of the property remained at a standstill after about January 1, 1907. Its fair market value at that time was five thousand dollars, and the same buildings were on it at that time as were on it in January 1, 1900, and on January 1, 1909. The property was not changed or improved during this period. The increase in value from January 1, 1900, to January 1, 1907, was because of general improvement in business conditions in Cadillac and general improvements in the city not only in business but in city matters. Several large factories were added between 1900 and 1907, and along about 1907 there was a very strong demand for business property due to improvements on the street. There was a general demand at that time which we have never exceeded since. The improvements made about that time were the building of the Peoples Savings Bank, the new Y. M. C. A. building, the Realty Block, and the Cobbs & Mitchell office.

L. T. M. Foster recalled for further cross-examination by Mr. Walker.

We carry a surplus account on our books.

Q. "Will you turn to that account for the years 1910, 1911, and 1912. What do you carry into that account as surplus at the close of each fiscal year—I don't mean what amounts, but where do you get it from?

A. It is the entire gain of the year's business.

Q. As shown upon the closing of your profit and loss account for the fiscal year?

A. Yes, sir."

All of the income or profit producing items are closed into profit and loss account. When there is a balance to the credit of that account—a gain—that is closed or carried into the surplus account, and then, if dividends are declared, they are charged against the surplus account. The total surplus on hand on the first of January, 1909, was $782,000. The fiscal year closed September 30, 1908, and this surplus I have just given you is the surplus at the close of that fiscal year. It was not changed on the books the first of January, 1909, and was not changed until the close of the next fiscal year. The dividend paid during the fiscal year of 1908 before this surplus of $782,000 was $30,000.

The surplus at the end of the fiscal year of 1909, Sep-
90 tember 30th, was $985,000. The dividend paid in the meantime was $75,000.

For the year ending September 30th, 1910, the surplus was $1,192,000, and the dividend paid $75,000.

For the year ending September 30th, 1911, the surplus was $1,305,000 and the dividend paid $90,000.

For the year ending September 30th, $1,258,000, and the dividend paid $210,000. The first dividend paid as shown on the books was in 1908—that is as far back as this record goes. It is as far back as the ledger goes.

These schedules that have been introduced in evidence, these typewritten ones or the ones from which they were copied, were prepared at the time of the returns. These are true typewritten copies made from these same schedules. They are the original copies.

Mitchell Brothers have approximately five years more of operation on these lands. It is a question what will be done with their railroad and mills and things of that sort at the end of that time. There is one saw mill at Jennings, in Missaukee County, at a railroad point. The saw mill machinery is movable, practically all of it. The saw mill machinery at Jennings was new. It was assembled there before my time, a good deal of it—some of it in 1905. That was the year I came there. Some of it since.

All this timber that is cut from these timber lands was shipped to Jennings and manufactured there into lumber. So far as I know the mill at Jennings has always been one mill—all under one roof. There is more than one machine. It is twelve miles from Cadillac.

The manufactured lumber is loaded on the cars at Jennings and shipped chiefly to wholesalers. We don't run a retail yard.

The company has bought—invested some of its surplus funds—in new tracts of timber in Oregon. To my knowledge they have done no lumbering there.

I didn't make the estimate that the life of the timber that remained would be five years; I got it from Mr. Mitchell. We have no other timber holdings in Michigan besides those in Missaukee and Kalkaska Counties that we were talking about.

The mill is operated by steam power.

The Court. Plaintiff rests.

Mr. Norris. If the court please, the testimony being closed, I suppose the next thing is to argue the case.

The Court. I suppose it is.

Mr. Norris. If your Honor will indicate what propositions
91 of law you would like to have argued it may assist in the disposition of the case, both in the matter of brevity and final result.

The Court. The matter is purely, I think, questions of law. There does not seem to be any dispute as to the facts in the case; at least, I cannot now conceive of any disputed question of fact.

L. T. M. Foster recalled by Mr. Walker for further cross-examination:

Q. I wish you would give the total amount of receipts from lumber and lumber sold during these years, or if you can give it from lumber and all other products sold, in one sum, you may do that; I would like to know how much the sales were by the manufacturing company in the years ending—if you have the calendar years all right; if not, then the fiscal years.

A. I have the statements; the sales appear on the statements, and they are taken from the books."

The total sales in dollars for the calendar year 1909 was $335,256.03. This statement shows for the year ending December 31, 1909, under the head of credit, by sales $335,256.03, by inventory December 31, 1909, $321,445.50. Under the head of income it itemizes the sources from which the income originated, such as income on lumber operations $83,487.36 and from other different departments of the business. It shows a total gross income of $303,635.83.

Q. "What does the amount of the income there shown, gross income, differ from the sales?

The Court. Instead of figuring the gross income of the property they figured the gross amount of the net income; they deducted the operating expenses before calling it gross income."

This statement is the gross income shown on the return to the Government. The sales were taken for the calendar year, twelve months. So are all the other items.

These other statements show the amount of sales for these years.

Mr. Norris. They are all made up on the same basis.

Mr. Walker. The sales for the year ending December 31, 1910, as shown by this income statement were $368,702.48; December 31, 1911, $374,508.78; December 31, 1912, $446,372.18.

This system of inventorying that was followed in the year ending December 31 1909, was followed before December 31, 1909. Our inventory for 1908 was taken on the same basis and as the subsequent ones for the years in question.

92 The lumber inventory does not include anything besides the manufactured products of the company. That inventory that I read for 1909 of three hundred and some odd thousand dollars, shows the lumber inventory but nothing besides. The mill property itself, the saw mill property, is an account by itself, which is a reserve account and treated as such at the end of the year. It does not appear in the inventory. That is also true of machinery and other items that go into the mill. Our inventory would not include lumber manufactured and piled, and logs cut and not manufactured, or wood timber corded—nothing but lumber. I don't believe I could state how much lumber we had in the inventory on December 31, 1908, the statements show in dollars and cents.

"Mr. Walker. December 31st, 1908, have you the statement here that shows that?

Mr. Norris. You just read it.

Mr. Walker. I didn't read that. I had one for December 31st, 1909, inventory January 1, 1909, $321,076."

Form No. 637.

To be filled in by collectors.
List No. 895.
Class C-1.
Fourth District of Michigan.
To be filled in by Internal Revenue Bureau.
Assessment List Feb., 1910.
Page 30, Line 32.
Date received ———, 19—.

United States Internal Revenue.
Return of Annual Net Income.
(Section 38, Act of Congress, Approved August 5, 1909.)

Plaintiff's Exhibit 1, March 18, 1915. C. Hondelink.

Manufacturing Corporations.

Return of net income received during the year ending December 31, 1910, by Mitchell Brothers Company, a corporation, the principal place of business of which is located at Cadillac, in the State of Michigan.

1. Total amount of paid-up stock outstanding at close of year	$1,000,000.00
2. Total amount of bonded or other indebtedness outstanding at close of year	239,759.96
3. Gross income (see Note A)	303,685.63

Deductions.

4. Total amount of all the ordinary and necessary expenses of maintenance and operation of the business of the corporation (see Note B)	None.
5. (a) Total amount of losses sustained January 1 to December 31	None.
(b) Total amount of depreciation January 1 to December 31	$174,421.37
Total (see Note B)	174,421.37
6. Total amount of interest, January 1 to December 31, on bonded or other indebtedness to an amount not to exceed amount of paid-up capital at *at* close of year (see Note B)	21,141.13
7. (a) Total taxes paid, January 1 to December 31, imposed under authority of the United States or any State or Territory thereof	19,820.79
(b) Foreign taxes paid	None.
Total (see Note B)	19,820.79
8. Amount received by way of dividends upon stock of other corporations, joint stock companies, associations, and insurance companies subject to this tax	57,000.00
Total deductions	272,383.29
9. Net income	(31,302.34)
	99,811.43
10. Specific deduction from net income allowed by law	5,000.00
11. Amount on which tax at one per centum is to be calculated	(26,302.34)
	94,811.43
	Add tax $685.09

State of Michigan, county of Wexford, to wit:

William W. Mitchell, president, and ———, treasurer, of the Mitchell Brothers Company, corporation, whose return of annual net income is set forth above, being severally duly sworn, each for himself, deposes and says that the foregoing report and the several items therein set forth are, to his best knowledge and belief and from such information as he has been able to obtain, true and correct in each and every particular; that the amount of gross income therein set forth is the full amount of gross income, without any deduction whatsoever, received from all sources by said corporation during the year stated and that the net income therein set forth is the full amount on which the tax is proper to be assessed.

W. W. Mitchell, *President*, and
——— ———, *Treasurer*.

Sworn and subscribed to before me this 23rd day of February, 1910.

[SEAL.] SAMUEL H. MERRITT,
Notary Public.

My commission expires April 29, 1915.

NOTE A.—The gross income received during the year from all sources shall in the case of a manufacturing corporation consist of the total amount ascertained through an accounting that shows the difference between the price received for the goods as sold and the cost of such goods as manufactured. The cost of goods manufactured shall be ascertained by an addition of a charge to the account of the cost of goods as manufactured during the year of the sum of the inventory at beginning of the year and a credit to the account of the sum of the inventory at the end of the year. To this amount should be added all items of income received during the year from other sources, including dividends received on stock of other corporations, joint stock companies, and associations subject to this tax. In the determination of the cost of goods manufactured and sold as above such cost shall comprehend all charges for maintenance and operation of manufacturing plant, but shall not embrace allowances for depreciation of losses, which items shall be taken account of under the proper heading above as a deduction.

NOTE B.—The deductions authorized shall include all expense items under the various heads acknowledged as liabilities by the corporations making the return and entered as such on its books from January 1 to December 31 of the year for which return is made.

NOTE C.—This form, properly filled out and executed, must be in the hands of the collector of internal revenue for the district in which is located the principal office of the corporation making the return, on or before March 1.

J. O. L. L. F. S.
B. G. M.

The return of Mitchell Brothers Company shown on the reverse side of this sheet was amended, as shown in red ink, in accordance with the provisions of paragraph 4 of section 38, act of August 5, 1909.

W. H. OSBORN,
Commissioner, W. M. D.

(Date) December 10, 1913.

95 Approved: By order of the secretary. John Sheldon Williams, assistant secretary.

D. J. G.

Collector's office. Received Feb. 25, 1910. 4th Dist., Mich.

Form No. 637. U. S. Internal Revenue. Return of annual net income. (Sec. 38, act of Congress, August 5, 1909.) Manufacturing corporations. Return of net income received during the year ending December 31, 1909, by Mitchell Bros. Co., a corporation, the principal place of business of which is located at Cadillac, in the State of Michigan, Fourth Collection District, State of Michigan.

Abstract of Exhibit 2. Income tax return of plaintiff for the year ending December 31, 1910.

1. Total paid-up stock		$1,000,000.00
2. Total indebtedness		83,039.47
3. Gross income		(313,068.44)
		368,431.75
Deductions.		
4. Total expense of maintenance and operation	$ None	
5. (a) Total losses	None	
(b) Total depreciation	$167,700.27	
6. Total interest	17,248.54	
7. (a) Total taxes	31,827.47	
(b) Foreign taxes	None	
8. Amount of dividends upon stock of other corporations, etc	36,000.00	
Total deductions (see Note B)		252,776.28
9. Net income		(60,292.16)
		115,655.47
10. Specific deduction allowed by law		5,000.00
11. Amount on which tax at 1 per centum is to be calculated		(55,292.16)
		110,655.47
	add tax	$553.63

Duly sworn to on the 27th of February, 1910, by William W. Mitchell, president.

Received and filed collector's office, February 25, 1910.

Abstract of Exhibit 3. Income tax of plaintiff for the year ending December 31, 1911.

1. Total paid-up stock		$1,000,000.00
2. Total indebtedness		38,685.83
96 3. Gross income		(268,034.83)
		307,233.38
Deductions.		
4. Total expense of maintenance and operation	$ None	
5. (a) Total losses	None	
(b) Total depreciation	$168,235.54	
6. Total interest	2,318.54	
7. (a) Total taxes	27,261.92	
(b) Total depreciation	$168,235.01	
8. Amount of dividends upon stock of other corporations, etc	9,000.00	
Total deductions (see Note B)		206,815.47
9. Net income		$(61,219.27)
		100,417.91
10. Specific deduction allowed by law		5,000.00

11. Amount on which tax at 1 per centum is to be calculated		($56,219.27)
		95,417.91
		add tax $391.99

Duly sworn to on the 10th day of February, 1912, by Chas. T. Mitchell, vice-president.

Received and filed collector's office, February 13, 1912.

Abstract of Exhibit 4. Income tax return of plaintiff for the year ending December 31, 1912.

1. Total paid-up stock			$1,000,000.00
2. Total indebtedness			37,698.14
3. Gross income			(358,748.14)
			468,879.49
	Deductions.		
4. Total expense of maintenance and operation	$ None		
5. (a) Total losses	None		
(b) Total depreciation	$216,866.42		
6. Total interest	None		
7. (a) Total taxes	37,246.88		
(b) Foreign taxes	None		
8. Amount of dividends upon stock of other corporations, etc	22,500.00		
97 Total deductions (see Note B)			276,613.30
9. Net income			$(82,134.84)
			192,266.19
10. Specific deduction allowed by law			5,000.00
11. Amount on which tax at 1 per centum is to be calculated			(77,134.84)
			$187,266.19
			add tax $1,101.31

Duly sworn to on the 17th day of February, 1913, by W. W. Mitchell, President.

Received and filed Collector's Office, February 19, 1913.

Annual net income statement, year ending December 31st, 1909.

Plaintiff's Exhibit 24, March 18, 1915.
C. Hondelink, Reporter.

Income Statement.

Lumber.

Inventory January 1, 1909		$321,076.27

Cost of manufacture for year ending December 31, 1909.

Camp 29, provisions	$5,164.77
Camp Van	83.62
" 3, provisions	3,328.77
" 3, expense	4,067.88
" 33, expense	12,027.08
" 33, provisions	9,398.02
" 29, expense	8,415.01
" 34, expense	4,642.82
" 34, provisions	1,046.17
Labor on contract logs	11,634.91
Labor on logs used that were inventoried Jan. 1, 1909	2,721.36
Purchased logs	5,506.77
Loading expense	5,455.83
R. R. expense	33,443.29
Dock and boom	10,244.83
Sawmill help	38,859.92
Sawmill expense	3,728.00
Sawmill repairs	9,641.38
Yard help	27,472.11
Yard expense	3,999.91
Working at flooring plant	5,009.15
98 Oregon timber expense	2,106.00
Donation	675.40
Grand Rapids real estate expense	114.91
Incidental expense	30,844.48
Office expense	2,100.68
Telephone line expense	54.45
Barn expense	855.67
Insurance	9,462.90
Accident expense	20.00
Suspense	11.81

Credit.

By sales		$335,256.03
By inventory Dec. 31, 1909		321,445.50
Income on lumber	$83,487.36	
	$656,701.53	$656,701.53

Income.

Income on lumber operation	$83,487.36	
" " electric light operation	1,733.87	
" " bark operation	8,164.57	
" " siding operation	362.76	
" " chem. fuel operation	16,415.95	
" " chem. wood operation	15,330.33	
" " flooring operation	87,152.43	
" " flg. plant wood operation	5,192.93	
" " store	11,843.28	
" " C. C. Co. dividends	57,000.00	
" " machine shop operation	2,985.87	
" " rents	4,454.60	
" " special lumber and flooring	247.16	
" " shingles	100.27	
" " water rents	582.64	
" " sawmill wood	24.50	
" " stump land	8,607.11	
Gross income		$302,685.63

Depreciation.

Barn account	$147.40	
Camp tools and stock	3,525.28	
Camp No. 3, buildings	373.60	
Electric light plant	639.94	
Camp 3, spurs	2,875.00	
Camp 33, buildings	905.15	
99 Camp 33, spurs	3,858.84	
Flg. plant property	5,762.78	
Grand Rapids real estate	1,043.90	
Machine shop	281.67	
New office property	1,875.10	
New office furniture	296.82	
J. & N. E. R. R.	6,575.39	
J. & N. E. R. R. buildings	614.67	
J. & N. E. equipment and tools	3,402.21	
Real estate, Jennings	2,945.65	
Saw mill property	8,886.12	
Telephone line	123.24	
Tram switch and sheds	692.50	
Water works	1,965.46	
Right of way	73.50	
Camp 29, spurs	2,000.00	
	$51,864.22	$303,685.63

Depreciation on timber used during year ending December 31, 1909.

6,551,018 ft. hemlock, at $4.00	$26,204.07		
12,118,243 ft. maple, at $4.00	48,472.97		
3,973,123 ft. beech, at $2.00	7,946.25		
133,274 ft. birch, at $4.00	533.10		
1,450 ft. R. elm, at $8.00	11.60		
1,444,503 ft. S. elm, at $8.00	11,556.02		
35,822 ft. ash, at $8.00	286.58		
16,129 ft. cherry, at $10.00	161.29		
498,157 ft. B. wood, at $8.00	3,985.26		
83,284 ft. oak, at $10.00	832.84		
496,853 ft. pine, at $20.00	9,937.06		
625 ft. Ironwood, at $——			
25,352,481 ft.	$109,927.04		
Average, $4.33 per thousand.			
100 Depreciation on stump land	8,607.11		
Depreciation on wood timber used from timber lands, 16,092 cds., at 25c	4,023.00		
Total depreciation		$174,421.37	
Interest.			
General	10,702.54		
Oregon	10,438.59		
		21,141.13	
Taxes.			
General	16,758.40		
Oregon	2,599.93		
Flooring plant	462.46		
		19,820.79	
Dividend on other stock (C. C. Co.)		57,000.00	
			$272,383.29
			$31,302.34

(Copy.)

United States Internal Revenue.—Return of Annual Net Income.—Manufacturing Corporations.

Return of net income received during the year ending December 31, 1910, by Mitchell Brothers Company, a corporation, the principal place of business of which is located at Cadillac, in the State of Michigan.

1. Total amount of paid-up stock outstanding at close of year	$1,000,000.00
2. Total amount of bonded or other indebtedness outstanding at close of year	239,759.26
3. Gross income	303,685.63

	Deductions.	
4. Total amount of all the ordinary and necessary expenses of maintenance and operation of the business and properties of the corporation		None
5. (a) Total amount of losses sustained, Jan. 7 to *to* Dec. 31		None
(b) Total amount of depreciation, Jan. 1 to Dec. 31	$174,421.31	
Total	174,421.37	
6. Total amount of interest, Jan. 1 to Dec. 31 on bonded or other indebtedness to an amount not to exceed amount of paid-up capital at close of year		21,141.13
7. (a) Total taxes paid Jan. 1 to Dec. 31, imposed under authority of the United States or any State and Territory thereof		19,820.79
(b) Foreign taxes paid		None
Total		$19,820.79
8. Amount received by way of dividends upon stock of other corporations, joint-stock companies, associations, and insurance companies subject to this tax		57,000.00
Total deductions		$272,382.29
9. Net income		31,302.34
10. Specific deduction from net income allowed by law		5,000.00
11. Amount on which tax at one per centum is to be calculated		26,302.34

State of Michigan, county Wexford, to wit:

William W. Mitchell, president and treasurer of Mitchell Brothers Company corporation, whose return of annual net income is set forth above, being severally duly sworn, each for himself, deposes and says that the foregoing report and the several items therein set forth are, to his best knowledge and belief and from such information as he has been able to obtain, true and correct in each and every particular; that the amount of gross income therein set forth is the full amount of gross income, without any deduction whatsoever, received from all sources by the said corporation during the year stated, and that the net income therein set forth is the full amount on which the tax is proper to be assessed.

102 Sworn and subscribed to before me this 23d day of February, 1910.

W. W. MITCHELL,
President,
and
———*Treasurer*.

SAMUEL H. MERRITT (Seal),
Notary Public.
My commission expires April 29, 1913.

Annual Net Income Statement Year Ending December 31st, 1910.

Plaintiff's Exhibit 25, March 18, 1915.
C. Hondelink, Reporter.

Income Statement.
Lumber.

Inventory January 1, 1910	$321,445.40

Cost of Manufacture for Year Ending December 31, 1910.

Accident expense	$3,868.35
Barn expense	455.87
Labor on contract logs	9,408.77
Camp 33, expense	15,635.01
Camp 33, provisions	10,924.03
Camp 29, expense	15,270.35
Camp 29, provisions	11,576.49
Camp 34, expense	3,962.51
Camp 34, provisions	272.01
Dock and boom	7,692.73
Donation	960.58
Incidental expense	20,207.17
Insurance	6,925.98
Purchased logs	3,576.55
Loading expense	6,455.00
Office expense	2,085.76
R. R. expense	36,335.26
Saw mill help	39,122.91
Saw mill expense	4,481.18
Saw mill repairs	11,718.28
Suspense account	501.56
Telephone line expense	31.28
Yard help	28,045.26
Yard expense	4,065.36
Oregon timber expense	1,393.10
Cedar camp expense	4,717.63
Cedar camp provisions	1,606.98

	Spencer main line expense	$2,463.24	
	Working at flooring plant	4,151.81	
	By sales		$368,702.48
103	By inventory Dec. 31, 1910		307,211.51
	Income on lumber	96,557.48	
		$675,913.99	
			$675,913.99

Income.

Income on lumber	$96,557.48
Income on bark	9,023.34
Income on siding	426.60
Income on camp van	44.74
Income on camp 3 buildings	50.00
Income on chemical fuel	15,260.57
Income on chemical wood	12,781.58
Income on electric light	1,635.84
Income on flooring	110,343.29
Income on flooring plant wood	3,919.00
Income on Grand Rapids real estate	780.12
Income on machine shop	3,389.36
Income on office furniture	.67
Income on real estate, Cadillac	1,500.00
Income on rents	4,968.73
Income on special lumber and flooring	477.65
Income on Cadillac Chemical Co. dividends	36,000.00
Income on water rents	595.31
Income on store	12,030.15
Income on stump land	3,284.01
Gross income	$313,068.44

Depreciations.

Barn account	$143.31
Camp tools and stock	2,990.16
Camp 33, buildings	375.00
Camp 33, spurs	7,071.28
Camp 29, buildings	778.27
Camp 29, spurs	9,274.71
Electric light plant	575.95
Flooring plant property	7,148.68
Machine shop	253.50
New office property	1,781.36
New office furniture	398.22
J. & N. E. R. R.	6,017.25
Railroad buildings	533.20
Railroad equipment and tools	3,224.56
Real estate, Jennings	2,851.87
R. R. right of way	98.70

	Saw mill property	$8,262.17	
	Telephone line	107.75	
104	Tram, switch, and sheds	623.25	
	Water works	1,768.92	
	Forward	54,298.68	$313,068.44

Depreciation of timber used during year ending Dec. 31, 1910.

23,476 feet ash, at $8.00	$187.54	
471,569 feet B wood, at $8.00	3,772.55	
3,173,927 feet beech, at $2.00	6,347.85	
316,398 feet birch, at $4.00	1,265.59	
39,659 feet cherry, at $10.00	396.59	
3,104 feet cedar, at $1.00	3.10	
1,134,568 feet elm, at $8.00	9,076.54	
9,145,875 feet hemlock, at $4.00	36,583.50	
9,672,602 feet maple, at $4.00	38,690.41	
55,783 feet oak, at $10.00	557.83	
356,730 feet pine, at $20.00	7,134.78	
10,925 feet tamarack (ironwood), at $2.00	21.85	
24,404,616 feet	104,038.33	

Average, $4.26 per thousand.

"Annual net income statement," year ending December 31, 1911.

Depreciation on stump land	$3,284.01	
Depreciation on wood timber used from timber lands, 17,517 cords, at 25c	4,379.25	
Depreciation on old office property	1,500.00	
105 Depreciation on Grand Rapids real estate	200.00	
Total depreciation		$167,700.27

Interest.

General	$12,848.82	
Oregon	4,399.72	
		17,248.54

Taxes.

General	$28,533.72		
Oregon	2,509.56		
Flooring plant	784.19		
		$31,827.47	
Dividends on other stock (C. C. Co.)		36,000.00	
			$252,776.28
Net income			60,292.16
Specific deduction from net income allowed by law			5,000.00
Amount on which tax at one per centum is to be calculated			55,292.16
Amount of tax			552.92

Plf. Exhibit 26, March 15, 1915.

C. Hondelink, Reporter.

Income Statement—Lumber.

Inventory January 1, 1911		$307,211.51

Cost of manufacture for year ending Dec. 31, 1911.

Accident expense	$1,233.85	
Barn expense	413.07	
Camp 3, expense	3,428.65	
Camp 3, provisions	1,498.29	
Camp 23, expense	3,959.92	
Camp 23, provisions	1,497.31	
Labor on contract logs	11,256.48	
Camp 33, expense	11,214.65	
Camp 33, provisions	7,789.50	
Camp 29, expense	10,655.73	
Camp 29, provisions	8,107.21	
Cedar camp provisions	1,606.98	
Cedar camp expense	3,697.90	
Cedar camp logging	2,566.96	
106 Dock and boom	9,604.62	
Donation	602.86	
Incidental expense	19,632.78	
Insurance	6,567.09	
Purchased logs	8,875.42	

Loading expense	$8,306.14	
Office expense	1,791.29	
R. R. expense	38,138.03	
Sawmill help	46,031.88	
Sawmill expense	5,458.33	
Sawmill repairs	8,163.53	
Suspense account	363.74	
Telephone line expense	.99	
Oregon timber expense	2,370.50	
Yard help	28,773.58	
Yard expense	3,662.66	
Working on flooring plant	4,900.57	
Discount	6,519.60	
By sales		$374,508.78
By inventory Dec. 31, 1911		354,198.22
Income on lumber	152,805.58	
	728,707.00	728,707.00

Income.

Income on lumber	$152,805.58	
Income on bark	10,506.65	
Income on siding	255.23	
Income on camp van	201.64	
Income on chemical fuel	15,380.61	
Income on electric light	1,518.56	
Income on flooring	59,094.98	
Income on flooring plant wood	3,791.53	
Income on machine shop	2,761.17	
Income on rents	3,908.82	
Income on special flooring and lumber	607.72	
Income on Cadillac Chem. Co. dividends	9,000.00	
Income on water rents	377.25	
Income on store	13,602.62	
Income on stump land	1,819.72	
Income on sawmill wood	525.59	
Income on shingles	16.32	
		276,233.99
Loss on chemical wood	8,165.22	
107 Loss on Grand Rapids R. net coll	34.03	
		8,199.25
Gross income		268,034.74

Depreciation.

Barn account	$146.98
Camp tools and stock	2,512.42
Camp 33, buildings	625.00
Camp 33, spurs	7,942.50
Camp 29, buildings	980.00
Camp 29, spurs	9,734.24

Electric light plant		$518,35
Flooring plant property		7,514.60
Machine shop		234.29
New office property		1,692.28
New office furniture		375.25
J. & N. E. R. R		17,600.43
Railroad buildings		497.88
Railroad equipment and tools		3,384.30
Real estate, Jennings		2,566.68
R. R. right of way		98.70
Saw mill property		7,573.44
Telephone line		108.56
Tram, switch, and sheds		573.03
Water works		1,658.83
Camp 3, buildings		506.77
Camp 3, spurs		2,994.74
Camp 23, buildings		534.66
Camp 23, spurs		3,199.65
Cedar camp buildings		145.03
Spencer main line		3,338.37
	$77,056.98	$268,034.74

Depreciation on timber used during year ending Dec. 31, 1911.

66,842 feet ash, at $8.00	$534.74	
430,748 feet basswood, at $8.00	3,445.98	
2,055,830 feet beech, at $2.00	4,111.66	
514,534 feet birch, at $4.00	2,058.14	
25,075 feet cherry, at $10.00	250.75	
2,126 feet cedar, at $1.00	2.13	
915,492 feet elm, at $8.00	7,323.94	
108 5,922,131 feet hemlock, at $4.00	23,688.52	
9,609,415 feet maple, at $4.00	38,437.66	
14,208 feet oak, at $10.00	142.08	
176,777 feet pine, at $20.00	3,535.54	
186,210 feet tamarack, at $2.00	372.42	
195,919,388 feet	83,903.56	
Average, $4.21 per thousand.		
Depreciation on stump land	1,819.72	

Depreciation on wood timber used from timber lands, 21,819 cords at 25c	$5,454.75	
Total depreciation		$168,235.01
Interest—		
General		2,318.54
Taxes—		
General	24,231.27	
Oregon	3,030.65	
		27,201.92
Dividends on other stock (C. C. Co.)		9,000.00
		$206,815.47
Net income		61,219.27
Specific deduction allowed by law from net income		5,000.00
Amount on which tax at one per centum is to be calculated		56,219.27
Amount of tax		562.19

Annual net income statement year ending December 31st, 1912.

Plf. Exhibit 27. March 18, 1915. C. Hondelink, Reporter.

109 Plaintiff's Exhibit 27. Income statement. Lumber.

Inventory January 1, 1912	$354,198.22

Cost of manufacture for year ending December 31, 1912.

Accident expense	$1,072.36
Barn expense	792.59
Labor on contract logs	20,103.39
Cedar camp logging	4,683.43
Camp 3, expense	13,473.83
Camp 3, provisions	9,519.25
Camp 23, expense	17,108.70
Camp 23, provisions	9,648.01
Dock and boom	8,789.64
Donation	677.00
Incidental expense	21,349.96
Discount	6,390.28
Insurance	7,832.14
Purchased logs	4,444.07
Loading expense	6,407.48
Office expense	1,470.64
Railroad expense	42,669.29
Saw mill help	45,608.21
Saw mill expense	4,464.33
Saw mill repairs	9,388.04
Suspence account	366.64

Shingles	$54.20	
Telephone line expense	54.10	
Town wood	1.23	
Yard help	30,635.31	
Yard expense	4,715.53	
Working at flooring plant	7,587.63	
Oregon timber expense	1,346.96	
By sales		$446,372.18
By inventory Dec. 31, 1912	199,931.92	388,312.20
Income on lumber		
	$834,684.38	$834,684.38

Income.

Income on lumber	$119,931.92	
Income on bark	12,071.93	
Income on bevel siding	70.28	
Income on camp van	135.23	
Income on chemical fuel	10,528.12	
Income on chemical wood	737.06	
Income on cedar products	6,351.13	
Income on electric lights	574.24	
110 Income on flooring	47,867.37	
Income on flooring plant wood	3,892.29	
Income on machine shop	3,155.34	
Income on rents	4,606.99	
Income on hardwood ties	7,476.98	
Income on square timber	5,957.07	
Income on saw mill wood	85.52	
Income on water rents	629.61	
Income on stumpland	19,486.59	
Income on Cadillac Chemical Co.'s dividends	22,500.00	
Income on store	12,708.75	
	$358,766.49	
Loss Grand Rapids Com. & Rep.	18.23	
Gross income		$358,748.14

Depreciations.

Camp tools and stock	2,097.47	
Camp buildings	970.98	
Camp spurs	13,742.28	
Flooring plant property	6,763.14	
Machine shop	211.24	
New office property	1,607.67	
New office furniture	367.45	
M. B. Co.'s railroad	16,691.05	
M. B. Co.'s railroad buildings	443.10	

M. B. Co.'s railroad equip. and tools	$3,957.51	
M. B. Co.'s railroad right of way	98.70	
Real estate, Jennings	2,310.02	
Saw mill property	6,839.57	
Telephone line	95.00	
Trams, switch, and shed	515.73	
Water works	1,501.24	
	$58,217.15	$358,748.14

Depreciation on timber used during year ending December 31, 1912.

22,134 feet ash, at $8.00	$177.07	
452,043 feet basswood, at $8.00	3,616.34	
1,212,776 feet beech, at $2.00	2,425.55	
468,279 feet birch at $4.00	1,873.12	
111 4,085 feet cherry, at $10.00 L	40.85	
1,033 feet cedar, at $1.00	1.03	
1,805,208 feet elm, at $8.00	14,441.66	
12,538,446 feet hemlock, at $4.00	50,153.78	
10,527,015 feet maple, at $4.00	42,108.06	
25,311 feet oak, at $10.00	253.11	
342,096 feet pine, at $20.00	6,841.92	
82,369 feet tamarack, at $2.00	164.74	
27,480,795 feet	122,097.23	
Average, $4.44 per thousand.		
Depreciation on stump land	19,486.59	
Depreciation on square timber	5,957.07	
Depreciation on cedar products	6,351.13	
Depreciation on wood timber used from timber lands, 19,029 cords, at 25c	4,757.25	
Total depreciation		158,649.27
Interest.		
General		None
Taxes.		
General	33,776.95	
Oregon	3,469.93	
		37,246.88
Dividends on other stock (C. C. Co.)	22,500.00	
		276,613.30
Net income		82,134.84

Specific deduction allowed by law from net income	$5,000.00
Amount on which tax at one per centum is to be calculated	77,134.84
Amount of tax	771.35

112 Plaintiff's Exhibit 33.

March 18, 1915. C. Hondelink, reporter.

Statement of material sold and certified to cedar products account:
31,015 fence posts, 3½ inch and up top.
7,332,250 shingles, 16-inch.
15,853 6 inch by 8 inch railroad ties.
575 cords 4-foot pulp wood.
Cedar poles:

4—20′ —5″	top
1—25′ —4″	top
105—25′ —5″	top
212—25′ —6″	top
25—25′ —7″	top
69—30″—5″	top
442—30″—6″	top
50—30′ —7″	top
243—35′ —6″	top
42—35′ —7″	top
37—40′ —6″	top
17—40′ —7″	top
5—45′ —6″	top
5—45′ —7″	top
6—50′ —7″	top

30 miscellaneous sizes and lengths.
About 2,000 pieces cull posts and ties.

Written findings of fact and of law were in writing duly and timely requested, and in pursuance thereof written findings of fact and conclusions of law were thereafter duly and timely drafted and proposed.

Thereupon the defendant duly and timely, in writing, preferred certain proposed amendments to such findings of fact and conclusions of law and requested that the same be allowed.

Among other such requested amendments to such findings of fact, and that were refused and disallowed by the court, were the following:

7. Strike out of Paragraph XIX of said findings the following:

"Which constituted a part of its capital assets on December 31st, 1908, and on January 1st, 1909."

To which refusal to allow such proposed amendment and finding the defendant, by his attorney, did then and there duly except.

8. Strike out of Paragraph XX of such finding the following:
113 "Which constituted a part of its capital assets on December 31st, 1908, and on January 1st, 1909."

To which refusal to allow such proposed amendment and finding the defendant, by his attorney, did then and there duly except.

9. Strike out of Paragraph XXI of such finding the following: "Which constituted a part of its capital assets on December 31st, 1908, and on January 1st, 1909."

To which refusal to allow such proposed amendment and finding the defendant, by his attorneys, did then and there duly except.

10. Strike out of Paragraph XXII of such finding the following: "Which constituted a part of its capital assets on December 31st, 1908, and on January 1st, 1909."

To which refusal to allow such proposed amendment and finding the defendant, by his attorney, did then and there duly except.

11. Insert after Paragraph XXVIII, the following to stand as XXVIII-a:

XXVIII-a.

None of these items or amounts shown in Paragraphs XXIII to XXVIII, inclusive, of these findings, has been or were charged or carried as depreciation in the accounts or upon the books of the plaintiff.

To which refusal to allow such proposed amendment and finding the defendant, by his attorney, did then and there duly except.

12. Insert after Paragraph XXX of said finding the following, to stand as XXX-a:

XXX-a.

None of these items or amounts, as shown in Paragraphs XXIX to XXX, inclusive, of these findings, had been or were charged or carried as depreciation in the accounts or upon the books of the plaintiff.

To which refusal to allow such proposed amendment and finding the defendant, by his attorney, did then and there duly except.

The preferred amendments to the proposed conclusions of law were disallowed by the court and were the following:

1. Strike out all the conclusions from II to VI, inclusive, and XI to XIV, inclusive, and XVII to XVIII, inclusive, and insert in lieu thereof the following:

II.

114 The cutting, manufacture, and sale of the timber stumpage, wood timber, square timber, and cedar products were not a sale of capital assets and the plaintiff was not entitled to deduct the same from income as depreciation for the purposes of the income tax returns and was properly assessed therefor and is not entitled to recover the taxes paid thereon.

To which refusal to allow such proposed amendment and conclusion the defendant, by his attorney, did then and there duly except.

2. Strike out Paragraphs VII to X of said conclusions and insert in lieu thereof the following:

III.

The sale of said stump lands was not a sale of capital assets and the plaintiff was not entitled to deduct the same from income as depreciation for the purposes of the income tax returns and was properly assessed therefor and is not entitled to recover the income tax paid thereon.

To which refusal to allow such proposed amendment and conclusion the defendant, by his attorney, did then and there duly except.

3. Strike out Paragraphs XV and XVI of said conclusions and insert in lieu thereof the following:

IV.

As to the amount of $1,500.00, part of the selling price of $5,000.00, the company's old office at Cadillac, sold by Mitchell Brothers in the year 1910 and carried on the books of the company at $3,300.00, and as to the $200.00, part of the selling price of $700.00 of the company's real estate in Grand Rapids, sold during the year 1910 and carried on the books of the company at $500.00, as to such excess or gain over the book value, said sales did not constitute a sale of the capital asset but were a part of the income of said plaintiff in said years for the purposes of the income tax.

To which refusal to allow such proposed amendment and conclusion the defendant, by his attorney, did then and there duly except.

4. Insert Conclusion V as follows:

V.

Judgment is therefore directed to be entered for the defendant for costs of this suit to be taxed.

To which refusal to allow such proposed amendment and conclusion the defendant, by his attorney, did then and there duly except.

115 And thereupon the court, in pursuance of such written requests, duly and timely made and found the findings of fact and conclusions of law, as follows:

United States of America, the District Court of the United States for the Western District of Michigan, Southern Division.

Mitchell Brothers Company, plaintiff, vs. Emanuel J. Doyle, as United States collector of internal revenue for the fourth collection district of Michigan, defendant.

This cause having been tried before the court without a jury, upon stipulation between the parties, and a request for findings of fact and conclusions of law having been made, the court finds as follows:

Findings of fact.

I.

This is an action brought by Mitchell Brothers Company, a corporation, against Emanuel J. Doyle, as collector of internal revenue for the fourth collection district of Michigan, to recover from the collector certain taxes paid to him under protest on December 22, 1913. The taxes sought to be recovered were assessed against the corporation by the Commissioner of Internal Revenue as additional taxes under the corporation excise tax law of August 5, 1909, for the years 1909, 1910, 1911, and 1912.

II.

Mitchell Brothers did, for each of the years 1909, 1910, 1911, and 1912, make a return of its income to the collector of internal revenue under the corporation excise tax law, and it did, in each of such years, pay the amount of the tax levied upon the return of income thus made. The amount paid for the year 1909 was $263.02; for the year 1910, $552.92; for the year 1911, $562.19; and for the year 1912, $771.35.

III.

On September 16, 1913, the Commissioner of Internal Revenue advised Mitchell Brothers Company of the proposed levy of an additional assessment against it for the years mentioned, and gave that company until October 5th to show cause why the additional assessment should not be made. This time was later extended until October 30th. A showing was made by Mitchell Brothers Company within the time required why the additional assessment should not be made, but on December 4, 1913, the Commissioner of Internal Revenue advised the company by letter to its attorney, Mark Norris, that the additional assessment had been confirmed.

116 IV.

An appeal to the Secretary of the Treasury was asked, but this was denied; and on December 12, 1913, the collector of internal revenue demanded of Mitchell Brothers Company the payment of the additional tax, which amounted to $2,732.02, divided as follows: For the year 1909, $685.09; for the year 1910, $553.63; for the year 1911, $391.99; and for the year 1912, $1,101.31. The tax demanded was paid under protest on December 22, 1913, and on the same date a claim for refund was made and filed. The claim for refund was denied on April 13, 1914, and subsequent to that time, viz, on October

5, 1914, this suit was commenced. All of the proceedings required by law to be taken before the commencement of suit were properly had and taken.

V.

The additional assessment levied by the Commissioner of Internal Revenue against Mitchell Brothers Company for the years 1909 to 1912, inclusive, was based upon certain items which Mitchell Brothers Company had deducted from the net income for the various years, on the theory that such items constituted a sale of its assets and were therefore properly chargeable back and properly to be deducted as restoration or as depreciation of capital assets. These items are as follows:

For the year 1909:

(1) For merchantable timber stumpage cut and converted charged by Mitchell Brothers Company $109,927.04; allowed by the United States, $54,048.06. Difference disallowed, $55,878.98.

(2) For stump lands sold, $8,607.11, disallowed by the United States.

(3) For wood sold or wood stumpage converted, $4,023, disallowed by the United States.

Total disallowance for the year, $68,509.09, on which tax of $685.09 reassessed.

For the year 1910:

(1) For merchantable timber stumpage cut and converted charged by Mitchell Brothers Company, $104,088.33; allowed by United States, $58,088.28. Difference disallowed, $46,000.05.

(2) For stump lands sold, $3,284.01, disallowed by the United States.

(3) For wood sold or wood stumpage converted, $4,379.25, disallowed by the United States.

(4) For company's old office at Cadillac sold, $1,500, disallowed by the United States.

117 (5) For Grand Rapids real estate sold $200.00 disallowed by United States.

Total disallowance for year, $55,363.31, on which tax of $553.63 reassessed.

For the year 1911:

(1) For merchantable timber stumpage cut and converted, charged by Mitchell Brothers Co., $83,903.56; allowed by United States, $51,979.39. Disallowed by United States, $31,924.17.

(2) For stump lands sold $1,819.72, disallowed by United States.

(3) For wood sold or wood stumpage converted, $5,454.75; disallowed by the United States.

Total disallowance for year, $39,198.64, on which tax of $391.99 was reassessed.

For the year 1912:

(1) For merchantable timber stumpage cut and converted charged by Mitchell Bros. Co., $122,097.23; allowed by United States, $48,517.92. Difference disallowed, $73,579.31.

(2) For stump lands sold, $19,486.59 disallowed by United States.

(3) For square timber products sold, $5,957.07; disallowed by United States.

(4) For cedar products sold, $6,351.13; disallowed by United States.

(5) For wood sold or wood stumpage converted, $4,757.25; disallowed by United States.

Total disallowance for year, $110,131.35, on which tax of $1,101.31 reassessed.

VI.

In order to eliminate from the suit unnecessary items of plaintiff's books and of its income returns, it was stipulated between counsel for the respective parties that the foregoing items should be the only ones at issue in the case.

VII.

Mitchell Brothers Company purchased all of its timber lands prior to January 1, 1909. Most of the lands were purchased many years ago by W. W. Mitchell and A. W. Mitchell, who carried on the business as co-partners until 1903, when the present corporation was organized. Some time prior to the reorganization, the partners revalued their lands, placing various prices on various descriptions, which prices approximated an average valuation of $20.00 per acre.

The lands were turned over to the corporation on this basis, and
118 have remained on the books at the same valuation to this date.

There has been nothing added since the incorporation, all taxes being absorbed in each year's business. The increase in value since the organization of the corporation has never been taken account of on its books.

VIII.

At about the time of its organization, the company adopted in its bookkeeping the following method of keeping its timber land accounts: At the end of each year there was transferred from the timber land account into the lumber account, the timber which had been cut and manufactured into lumber during the year, and there was transferred into the stump land account the lands which had been cut over during the year. This transfer was made by crediting the timber land account with all hardwood and hemlock timber cut at the rate of $2.25 per thousand, with all pine timber cut at the rate of $8.00 per thousand, and with all lands cut over at the rate of $2.00 per acre, and by making a corresponding charge of the same items to the lumber and stump land accounts respectively. It was estimated at that time that by using these figures of $2.25 and $8.00 per thousand for stumpage, and $2.00 per acre for stump lands, the timber land account would just about be wiped out when all the timber was removed. On account of closer cutting in later years this proved

untrue, but the company has, nevertheless, continued to use the same figures in its bookkeeping down to the present time.

VIII-a.

The average cut of stumpage per acre for the fiscal years ending September 30, 1909, 1910, 1911, and 1912, respectively, was 15,461. The total cut of stumpage for the calendar years ending December 31, 1909, 1910, 1911, and 1912, respectively, was:

Hardwood	93,843,666 feet
Softwood	3,324,982 feet
Cedar and tamarack	93,128 feet

The hardwood cut was 96–482–1,000% of the whole stumpage cut. The softwood was 3–319–1,000% of the whole cut and the cedar and tamarack was 199–1,000% of the whole cut. The average cut for these years of hardwood stumpage per acre was 14,917 feet; softwood, 513.5 feet; and cedar and tamarack, 30.5 feet.

At $2.25 per thousand stumpage for hardwood and $8.00 per thousand stumpage for softwood, the average amount produced per acre for stumpage for these years was $38.57. This exceeds the
119 average inventory cost per acre of $20.00 in the amount of $18.57 per acre.

There was also realized from the by-products of the timber cut on these lands in these years the following:

Square timber—1912	5,957.07
Cedar products—1912	6,351.13

IX.

After the corporation excise tax law went into effect and preparatory to making its income return for the year 1909 under the law Mitchell Brothers Company revalued its timber stumpage as of December 31, 1908 (or as of January 1, 1909, the date the law became effective), at the following rates per thousand feet, log scale:

Ash stumpage, $8.00 per thousand feet, log scale.
Basswood stumpage, $8.00 per thousand feet, log scale.
Beech stumpage, $2.00 per thousand feet, log scale.
Birch stumpage, $4.00 per thousand feet, log scale.
Cedar stumpage, $1.00 per thousand feet, log scale.
Cherry stumpage, $10.00 per thousand feet, log scale.
Elm stumpage (both hard and soft), $8.00 per thousand feet, log scale.
Hemlock stumpage, $4.00 per thousand feet, log scale.
Ironwood stumpage, $2.00 per thousand feet, log scale.
Maple stumpage, $4.00 per thousand feet, log scale.
Oak stumpage, $10.00 per thousand feet, log scale.
Pine stumpage, $20.00 per thousand feet, log scale.
Tamarack stumpage, $2.00 per thousand feet, log scale.

IX-a.

These revaluations were for the purpose of the income tax law and the returns to be made thereunder. No actual new inventory of the timber lands or the stumpage was in fact taken. In making this revaluation the vice-president of the plaintiff company, after the close of the calendar year 1909 and in the fore part of 1910, put his estimate of the market value as of December 31, 1908, upon the various kinds of stumpage cut in the calendar year ending December 31, 1909. This valuation did not then, nor at any time, appear upon and was not taken from the books of the plaintiff and had not been and was not then or thereafter, charged or entered therein as depreciation. The same is true as to the depreciation for timber stumpage which entered into the deductions from the gross income in the income tax returns for the subsequent years in question, viz, the years ending December 31, 1910, December 31, 1911, and December 31, 1912, respectively.

IX-b.

120 The amount of hardwood stumpage at $2.25 per thousand and of softwood stumpage at $8.00 per thousand as cut, together with the cost of cutting and hauling, was debited to closing log account and credited to stumpage account. The lumber sold was credited to lumber account and at the end of the fiscal year closing log account was closed into lumber account and both stumpage account and the balance of lumber account was closed into profit and loss account.

For the fiscal year ending September 30, 1909, the timber stumpage cut at $2.25 and $8.00 per thousand respectively, in the amount of $54,048 was thus debited to closing log account and credited to stumpage account.

For the fiscal years ending 1910, 1911, and 1912 the method was the same.

IX-c.

Stumpage lands, so-called, that is, cut over lands, were sold by the plaintiffs in the years in question, as follows:

For the year ending—	
Dec. 31, 1909. 2,080 A., average price per A., $6.84	$14,230.00
Dec. 31, 1910. 640 A., average price per A., $3.97	2,545.00
Dec. 31, 1911. 680 A., average price per A., $10.15	6,900.00
Dec. 31, 1912. 1,542 A., average price per A., $11.11	17,059.71

The cost or inventory price to the plaintiff of these stumpage lands when originally purchased, so far as they appear upon the inventory book, together with the timber thereon (then called timber lands), is as follows:

1,880 acres of stumpage lands sold in 1909 were originally purchased at an average price per acre of $7.45, $14,008. 600 acres of

stumpage lands sold in 1909 were originally purchased at an average price per acre of $4.44, $2,664. 480 acres of stumpage lands sold in 1909 were originally purchased at an average price per acre of $19.60, $9,410. 1,280.54 acres of stumpage lands sold in 1909 were originally purchased at an average price of $17.79, $22,786.

IX-d.

The plaintiff is a lumber manufacturing corporation which runs its own mills, owns, cuts, and manufactures into lumber therein its own stumpage and sells the lumber in the market, and from these sales and the sales of the various by-products, wood timber, square timber, and cedar products, makes its profits, declares its dividends and creates its surplus. This is its sole business.
121 It is not a real estate trading corporation. It sells its stumpage lands, so-called, after the timber is cut and removed.

IX-e.

Before January 1, 1909, the plaintiff had cut stumpage from its timber lands and manufactured into lumber more than enough at $2.25 per thousand for hardwood and $8.00 per thousand for softwood, to pay the original inventory cost to plaintiff of such timber lands.

X.

Against its income for the year 1909, Mitchell Brothers Company charged an item of $109,927.04 for timber stumpage cut and converted during the year, which amount was arrived at as shown by the following table:

6,551,018	ft. hemlock, at $4.00	$26,204.07
12,118,243	ft. maple, at $4.00	48,472.97
3,973,123	ft. beech, at $2.00	7,946.25
133,274	ft. birch, at $4.00	533.10
1,450	ft. R. elm, at $8.00	11.60
1,444,503	ft. S. elm, at $8.00	11,556.02
35,822	ft. ash, at $8.00	286.58
16,129	ft. cherry, at $10.00	161.29
498,157	ft. B. wood, at $8.00	3,985.26
83,284	ft. oak, at $10.00	832.84
496,853	ft. pine, at $20.00	9,937.06
025	ft. ironwood, at $——	
25,352,481	Total	$109,927.04

XI.

Against its income for the year 1910, Mitchell Brothers Company charged an item of $104,038.33 for timber stumpage cut and converted

during the year, which amount was arrived at as shown by the following table:

23,467 ft.	ash, at $8.00	$187.54
471,569 ft.	B. wood, at $8.00	3,772.55
3,173,927 ft.	beech, at $2.00	6,347.85
316,398 ft.	birch, at $4.00	1,265.59
39,659 ft.	cherry, at $10.00	396.59
3,104 ft.	cedar, at $1.00	3.10
1,134,568 ft.	elm, at $8.00	9,076.54
9,145,875 ft.	hemlock, at $4.00	36,583.50
9,672,602 ft.	of maple, at $4.00	38,680.41
55,783 ft.	oak, at $10.00	557.83
356,739 ft.	pine, at $20.00	7,134.78
10,925 ft.	tamarack, at $——	
	Ironwood, at $2.00	21.85
24,404,616	Total	$104,038.33

122

XII.

Against its income for the year 1911, Mitchell Brothers Company charged an item of $83,903.56 for timber stumpage cut and converted during the year, which amount was arrived at as shown by the following table:

66,842 ft.	ash, at $8.00	$534.74
430,748 ft.	basswood, at $8.00	3,445.98
2,055,830 ft.	beech, at $2.00	4,111.66
514,534 ft.	birch, at $4.00	2,058.14
25,075 ft.	cherry, at $10.00	250.75
2,126 ft.	cedar, at $1.00	2.13
915,492 ft.	elm, at $8.00	7,323.94
5,922,131 ft.	hemlock, at $4.00	23,688.52
9,609,415 ft.	maple, at $4.00	38,437.66
14,208 ft.	oak, at $10.00	142.08
176,777 ft.	pine, at $20.00	3,535.54
186,210 ft.	tamarack, at $2.00	372.42
19,919,388	Total	$83,903.56

XIII.

Against its income for the year 1912, Mitchell Brothers Company charged an item of $122,097.23 for timber stumpage cut and converted during the year, which amount was arrived at as shown by the following table:

22,134 ft.	ash, at $8.00	$177.07
452,043 ft.	basswood, at $8.00	3,616.34
1,212,776 ft.	beech, at $2.00	2,425.55

468,279	ft. birch, at $4.00	$1,873.12
4,085	ft. cherry, at $10.00	40.85
1,033	ft. cedar, at $1.00	1.03
1,805,208	ft. elm, at $8.00	14,441.66
12,538,446	ft. hemlock, at $4.00	50,153.78
10,527,015	ft. maple, at $4.00	42,108.06
25,311	ft. oak, at $10.00	253.11
342,096	ft. pine, at $20.00	6,841.92
82,369	ft. tamarack, at $2.00	164.74
27,480,795	Total	$122,097.23

XIV.

The fair market value on December 31, 1908, on January 1, 1909, and during the years 1909, 1910, 1911, and 1912, of the timber stumpage owned by Mitchell Brothers Company on December 31, 1908, and cut and converted by it during the years 1909 to 1912, inclusive, was as follows:

Ash stumpage, $8.00 per thousand feet, log scale.

Basswood stumpage, $8.00 per thousand feet, log scale.

123 Beech stumpage, $2.00 per thousand feet, log scale.

Birch stumpage, $4.00 per thousand feet, log scale.

Cedar stumpage, $1.00 per thousand feet, log scale.

Cherry stumpage, $10.00 per thousand feet, log scale.

Elm stumpage (both hard and soft), $8.00 per thousand feet, log scale.

Hemlock stumpage, $4.00 per thousand feet, log scale.

Ironwood stumpage, $2.00 per thousand feet, log scale.

Maple stumpage, $4.00 per thousand feet, log scale.

Oak stumpage, $10.00 per thousand feet, log scale.

Pine stumpage, $20.00 per thousand feet, log scale.

Tamarack stumpage, $2.00 per thousand feet, log scale.

XV.

The court finds that during the year 1909 Mitchell Brothers Company cut and converted timber stumpage from its timber lands as follows:

6,551,018	ft. hemlock
12,118,243	ft. maple
3,973,123	ft. beech
133,274	ft. birch
1,450	ft. R. elm
1,444,503	ft. S. elm
35,892	ft. ash
16,129	ft. cherry
496,157	ft. B. wood
83,284	ft. oak
496,853	ft. pine
625	ft. Ironwoood

The fair market value of this stumpage on December 31, 1908, on January 1, 1909, and during the year 1909 was $109,927.04, or an average of $4.33 per thousand feet.

XVI.

The court finds that during the year 1910 Mitchell Brothers Company cut and converted timber stumpage from its timber lands as follows:

23,467	ft. ash
471,569	ft. B. wood
3,173,927	ft. beech
316,398	ft. birch
39,659	ft. cherry
3,104	ft. cedar
1,134,568	ft. elm
9,145,857	ft. hemlock
9,672,602	ft. maple
55,783	ft. oak
356,739	ft. pine
10,925	ft. tamarack

124 The fair market value of this stumpage on December 31, 1908, on January 1, 1909, and during the years 1909 and 1910, was $104,088.33, or an average of $4.26 per thousand feet.

XVII.

The court finds that during the year 1911 Mitchell Brothers Company cut and converted timber stumpage from its timber lands as follows:

66,842	ft. ash
430,748	ft. basswood
2,055,830	ft. beech
514,534	ft. birch
25,075	ft. cherry
2,126	ft. cedar
915,492	ft. elm
5,922,131	ft. hemlock
9,609,415	ft. maple
14,208	ft. oak
176,777	ft. pine
186,210	ft. tamarack

The fair market value of this stumpage on December 31, 1908, on January 1, 1909, and during the years 1909, 1910 and 1911 was $83,906.56, or an average of $4.21 per thousand feet.

XVIII.

The court finds that during the year 1912 Mitchell Brothers Company cut and converted timber stumpage from its timber lands as follows:

22,134	ft. ash
452,043	ft. basswoood
1,212,776	ft. beech
468,279	ft. birch
4,085	ft. cherry
1,033	ft. cedar
1,805,208	ft. elm
12,538,446	ft. hemlock
10,527,015	ft. maple
25,311	ft. oak
342,096	ft. pine
82,369	ft. tamarack

The fair market value of this stumpage on December 31, 1908, on January 1, 1909, and during the years 1909, 1910, 1911 and 1912 was $122,097.23, or an average of $4.44 per thousand feet.

XIX.

During the year 1909 Mitchell Brothers Company sold cer-
125 tain stump lands which constituted part of its capital assets on December 31, 1908, and on January 1, 1909. The fair market value on December 31, 1908, on January 1, 1909, and during the year 1909, of the stump land thus sold during the year 1909 was $8,607.36.

XX.

During the year 1910 Mitchell Brothers Company sold certain stump lands which constituted part of its capital assets on December 31, 1908, and on January 1, 1909. The fair market value on December 31, 1908, on January 1, 1909, and during the years 1909 and 1910, of the stump lands thus sold during the year 1910 was $3,284.01.

XXI.

During the year 1911 Mitchell Brothers Company sold certain stump lands which constituted part of its capital assets on December 31, 1908, and on January 1, 1909. The fair market value on December 31, 1908, on January 1, 1909, and during the years 1909, 1910, and 1911 of the stump lands thus sold during the year 1911 was $1,819.72.

XXII.

During the year 1912 Mitchell Brothers Company sold certain stump lands which constituted part of its capital assets on December

31, 1908, and on January 1, 1909. The fair market value on December —, 1908, on January 1, 1909, and during the years 1909, 1910, 1911, and 1912 of the stump lands thus sold during the year 1912 was $13,659.83.

Through an error in addition made in the making up of the return for 1912, Mitchell Brothers Company charged back for restoration or depreciation of capital assets on account of stump lands sold during that year, $19,486.59 instead of $13,659.83, which latter amount was the correct amount. The same error in addition, however, was made in totaling the net income for that year, so that the error did not affect the result in so far as the taxable income of the company was concerned—the error of $5,826.76 having been included in the income and also included in the restoration or depreciation charged which was made against income.

XXIII.

During the year 1909 Mitchell Brothers Company cut and converted certain wood stumpage into 16,092 cords of four-foot wood. This wood stumpage was owned by Mitchell Brothers Company on December 31, 1908, and on January 1, 1909, and its fair market value on those dates and during the year 1909 was 25c. per cord, or a total value of $4,023.

value of $4,023.

126

XXIV.

During the year 1910 Mitchell Brothers Company cut and converted certain wood stumpage in 17,517 cords of four-foot wood. This wood stumpage was owned by Mitchell Brothers Company on December 31, 1908, and on January 1, 1909, and its fair market value on those dates and during the years 1909 and 1910 was 25c. per cord, or a total of $4,379.25.

XXV.

During the year 1911 Mitchell Brothers Company cut and converted certain wood stumpage in 21,819 cords of four-foot wood. This wood stumpage was owned by Mitchell Brothers Company on December 31, 1908, and on January 1, 1909, and its fair market value on those dates and during the years 1909, 1910, and 1911 was 25c. per cord, or a total value of $5,454.75.

XXVI.

During the year 1912 Mitchell Brothers Company cut and converted certain wood stumpage into 19,029 cords of four-foot wood. This wood stumpage was owned by Mitchell Brothers Company on December 31, 1908, and on January 1, 1909, and its fair market value on those dates and during the years 1909, 1910, 1911, and 1912 was 25c. per cord or a total of $4,757.25.

XXVII.

During the year 1912 Mitchell Brothers Company sold on the stump a certain quantity of square timber, which it owned on December 31, 1908, and on January 1, 1909. The fair market value on December 31, 1908, on January 1, 1909, and during the years 1909, 1910, 1911, and 1912 of the square timber so sold during the year 1912 was $5,957.07.

XVIII.

During the year 1912 Mitchell Brothers Company sold certain cedar products which it owned on December 31, 1908, and on January 1, 1909. The fair market value on December 31, 1908, on January 1, 1909, and during the years 1909, 1910, 1911, and 1912 of the cedar products so sold during the year 1912 was $6,351.13.

XXIX.

On May 5, 1910, Mitchell Brothers Company sold a parcel of real estate in Grand Rapids, Michigan, described as lot 164 and the west 38 feet of lot 165, Kellog & Bemis, addition to the city of Grand Rapids, for $700.00. This parcel of land had been carried on the books of the corporation and of the co-partnership preceding it since 1894 at a valuation of $500.00. In making its return of income
127 for the year 1910 Mitchell Bros. Company included in the net income the sum of $200.00, which sum was the difference between the amount this parcel of land had stood on the books of the company and the amount at which it had been sold. Mitchell Bros. Company also charged against income the same item of $200 on the theory that the disposition of the Grand Rapids real estate constituted a sale of capital assets and that no part of the selling price received was income within the meaning of the corporation excise tax law. The court finds that the fair market value on December 31, 1908, on January 1, 1909, and during the year 1909 and 1910 of the parcel of land referred to was $700.00.

XXX.

On January 31, 1910, Mitchell Bros. Co. sold a parcel of real estate in Cadillac, Michigan, described as No. 122 South Mitchell Street, Cadillac, for $5,000. This parcel of land was purchased prior to 1882 and since 1895 it had stood on the books of the co-partnership and of the corporation at a value of $3,500. In making its return of income for the year 1910 Mitchell Bros. Company included in the net income the sum of $1,500, which sum was the difference between the amount this parcel of land had stood on the books of the company and the amount at which it had been sold.

Mitchell Bros. Company also charged against income the same item of $1,500 on the theory that the disposition of the Cadillac

real estate constituted a sale of capital assets and that no part of the selling price received was income within the meaning of the corporation excise tax law. The court finds that the fair market value on December 31, 1908, on January 1, 1909, and during the years 1909 and 1910 of this parcel of land at Cadillac was $5,000.

XXX-a.

The amount of items of depreciation entered and shown in the accounts and upon the books of the plaintiff company for the years in question were as follows:

For the year 1909	$51,864.22
For the year 1910	54,298.68
For the year 1911	77,056.98
For the year 1912	58,217.15

These amounts were for the depreciation upon tools, fixtures, and buildings of the plaintiff and all of the depreciation made and deducted in the income tax returns except the above amounts did not appear and were not entered in the accounts or upon the books of the company.

128 XXX-b.

The actual profits of the plaintiff, as entered and shown in the accounts and upon the books of the company, as reported by the directors to the stockholders and from which dividends were declared and surplus created, were as follows:

For the fiscal year ending Sept. 30, 1909	$202,280.93
For the fiscal year ending Sept. 30, 1910	282,644.74
For the fiscal year ending Sept. 30, 1911	187,953.20
For the fiscal year ending Sept. 30, 1912	252,308.53

The dividend paid by the plaintiff for the fiscal year ending September 30, 1908, was $30,000 and after such payment the surplus was $782,000.

For the fiscal year ending September 30, 1909, the dividend paid was $75,000 and the surplus remainder $985,000.

For the fiscal year ending September 30, 1910, the dividend paid was $75,000 and the surplus remainder $1,192,000.

For the fiscal year ending September 30, 1911, the dividend paid was $90,000 and the surplus remainder $1,205,000.

For the fiscal year ending September 30, 1912, the dividend paid was $210,000 and the surplus remainder $1,258,000.

XXX-c.

The plaintiff company is a corporation issuing stock and having stockholders and directors, and as required by the by-laws and the act under which it is incorporated makes annual report showing the

assets, liabilities, business transacted, and profits made each year, and in the years in question such annual reports show profits made to the amounts above stated for the fiscal years, such amounts being the credit balances of profit and loss account and in the years in question the depreciations deducted in the income tax returns for such years went into and was treated as a part of the profits of the company except only as to the amounts deducted for actual depreciation upon the books of the company as above stated.

Conclusions of law.

I.

On December 22, 1913, plaintiff paid to the Collector of Internal Revenue for the fourth collection district of Michigan the sum of $2,732.02 pursuant to additional assessment made by the Commissioner of Internal Revenue against Mitchell Bros. Company
129 for the years 1909, 1910, 1911, and 1912 under the corporation excise tax law of August 5, 1909. This tax was paid under proper legal protest and after its payment proper legal claim for refund was made and filed, which claim was declined. After a compliance with all legal requisites preliminary to commencement of suit this suit was instituted.

II.

The said sum of $2,732.02 was illegally assessed against Mitchell Bros. Company by the Commissioner of Internal Revenue and was unlawfully collected by the collector of internal revenue. Mitchell Bros. Company is therefore entitled to recover that sum with interest at five per cent from December 22, 1913, the date of payment.

III.

The timber stumpage of Mitchell Bros. Company which was cut and converted during the year 1909 was owned by that company on December 31, 1908, and on January 1, 1909, and was at that time and during the year 1909 of the fair market value of $109,927.04. Mitchell Bros. Company was therefore entitled to deduct said amount of $109,927.04 from its net income for the year 1909;

First, because said stumpage was capital assets on December 31, 1908, and on January 1, 1909, and was not income within the meaning of the corporation excise tax law of August 5, 1909;

Second, because the cutting and conversion of said stumpage constituted a sale of the capital assets, and said amount was therefore properly deducted from income as and for restoration of capital assets;

Third, because the cutting and conversion of said stumpage constituted a depreciation of the capital assets of Mitchell Bros. Com-

pany, and said amount was therefore properly deducted from its income as and for depreciation of property;

Fourth, because the cutting and conversion of said stumpage constituted part of the cost of manufacture, and said amount was therefore properly deducted from its income as and for such cost of manufacture.

IV.

The timber stumpage of Mitchell Bros. Company which was cut and converted during the year 1910 was owned by that company on December 31, 1908, and on January 1, 1909, and was at that time and during the year 1909 and 1910 of the fair market value of $104,038.33. Mitchell Bros. Company was therefore entitled to deduct said amount of $104,038.33 from its net income for the year 1910;

130 First, because said stumpage was capital assets on December 31, 1908, and on January 1, 1909, and was not income within the meaning of the corporation excise tax law of August 5, 1909;

Second, because the cutting and conversion of said stumpage constituted a sale of the capital assets, and said amount was therefore properly deducted from income as and for restoration of capital assets;

Third, because the cutting and conversion of said stumpage constituted a depreciation of the capital assets of Mitchell Bros. Company, and said amount was therefore properly deducted from its income as and for depreciation of property;

Fourth, because the cutting and conversion of said stumpage constituted part of the cost of manufacture, and said amount was therefore properly deducted from its income as and for such cost of manufacture.

V.

The timber stumpage of Mitchell Bros. Company which was cut and converted during the year 1911 was owned by that company on December 31, 1908, and on January 1, 1909, and was at that time and during the years 1909, 1910, and 1911 of the fair market value of $83,903.56. Mitchell Bros. Company was therefore entitled to deduct said amount of $83,903.56 from its net income for the year 1911;

First, because said stumpage was capital assets on December 31, 1908, and on January 1, 1909, and was not income within the meaning of the corporation excise tax law of August 5, 1909;

Second, because the cutting and conversion of said stumpage constituted a sale of the capital assets, and said amount was therefore properly deducted from income as and for restoration of capital assets;

Third, because the cutting and conversion of said stumpage constituted a depreciation of the capital assets of Mitchell Bros. Co., and said amount was therefore properly deducted from its income as and for depreciation of property;

Fourth, because the cutting and conversion of said stumpage constituted part of the cost of manufacture, and said amount was therefore properly deducted from its income as and for such cost of manufacture.

VI.

The timber stumpage of Mitchell Bros. Co. which was cut and converted during the year 1912 was owned by that company
131 on December 31, 1908, and on January 1, 1909, and was at that time and during the years 1909, 1910, 1911, and 1912 of the fair market value of $122,097.23. Mitchell Bros. Co. was therefore entitled to deduct said amount of $122,097.23 from its net income for the year 1912.

First, because said stumpage was capital assets on December 31, 1908, and on January 1, 1909, and was not income within the meaning of the corporation excise tax law of August 5, 1909;

Second, because the cutting and conversion of said stumpage constituted a sale of the capital assets, and said amount was therefore properly deducted from income as and for restoration of capital assets;

Third, because the cutting and conversion of said stumpage constituted a depreciation of the capital assets of Mitchell Bros. Co., and said amount was therefore properly deducted from its income as and for depreciation of property;

Fourth, because the cutting and conversion of said stumpage constituted part of the cost of manufacture, and said amount was therefore properly deducted from its income as and for such cost of manufacture.

VII.

The stump land sold by Mitchell Bros. Co. during the year 1909 were owned by that company on December 31, 1908, and on January 1, 1909, and were at that time and during the year 1909 of the fair market value of $8,807.11. Mitchell Bros. Co. was therefore entitled to deduct said amount of $8,807.11 from the net income for the year 1909;

First, because said stump lands were capital assets on December 31, 1908, and on January 1, 1909, and were not income within the meaning of the corporation excise tax law of August 5, 1909;

Second, because the sale of said stump lands constituted a sale of capital assets, and said amount was therefore properly deducted from income as and for restoration of capital assets;

Third, because the sale of said stump lands constituted a depreciation of the capital assets of Mitchell Bros. Co., and said amount was therefore properly deducted from its income as and for depreciation of property.

VIII.

The stump lands sold by Mitchell Bros. Co. during the year 1910 were owned by that company on December 31, 1908, and on January

1, 1909, and were at that time and during the years 1909 and
132 1910 of the fair market value of $3,284.01. Mitchell Bros. Co. was therefore entitled to deduct said amount of $3,284.01 from the net income for the year 1910;

First, because said stump lands were capital assets on December 31, 1908, and on January 1, 1909, and were not income within the meaning of the corporation excise tax law of August 5, 1909;

Second, because the sale of said stump lands constituted a sale of capital assets, and said amount was therefore properly deducted from income as and for restoration of capital assets;

Third, because the sale of said stump lands constituted a depreciation of the capital assets of Mitchell Bros. Co., and said amount was therefore properly deducted from its income as and for depreciation of property.

IX.

The stump lands sold by Mitchell Bros. Co. during the year 1911 were owned by that company on December 31, 1908, and on January 1, 1909, and were at that time and during the years 1909, 1910, and 1911, of the fair market value of $1,819.72. Mitchell Bros. Co. was therefore entitled to deduct said amount of $1,819.72 from the net income for the year 1911;

First, because said stump lands were capital assets on December 31, 1908, and on January 1, 1909, and were not income within the meaning of the corporation excise tax law of August 5, 1909;

Second, because the sale of said stump lands constituted a sale of capital assets, and said amount was therefore properly deducted from income as and for restoration of capital assets;

Third, because the sale of said stump lands constituted a depreciation of the capital assets of Mitchell Bros. Co., and said amount was therefore properly deducted from its income as and for depreciation of property.

X.

The stump lands sold by Mitchell Bros. Co. during the year 1912 were owned by that company on December 31, 1908, and on January 1, 1909, and were at that time and during the years 1909, 1910, 1911, and 1912 of the fair market value of $19,486.59. Mitchell Bros. Co. was therefore entitled to deduct said amount of $19,486.59 from the net income for the year 1912;

First, because said stump lands were capital assets on December 31, 1908, and on January 1, 1909, and were not income within the meaning of the corporation excise tax law of August 5, 1909;

133 Second, because the sale of said stump lands constituted a sale of capital assets, and said amount was therefore properly deducted from income as and for restoration of capital assets;

Third, because the sale of said stump lands constituted a depreciation of the capital assets of Mitchell Bros. Co., and said amount was therefore properly deducted from its income as and for depreciation of property.

XI.

The wood stumpage cut and converted by Mitchell Bros. Co. during the year 1909 was owned by that company on December 31, 1908, and on January 1, 1909, and was at that time and during the year 1909 of the fair market value of $4,023. Mitchell Bros. Co. was therefore entitled to deduct said amount of $4,023 from the net income for the year 1909—

First, because said wood stumpage was capital assets on December 31, 1908, and on January 1, 1909, and was not income within the meaning of the corporation excise tax law of August 5, 1909;

Second, because the cutting and conversion of said wood stumpage constituted a sale of the capital assets, and said amount was therefore properly deducted from income as and for restoration of capital assets;

Third, because the cutting and conversion of said wood stumpage constituted a depreciation of the capital assets of Mitchell Bros. Co., and said amount was therefore properly deducted from its income as and for depreciation of property;

Fourth, because the cutting and conversion of said wood stumpage constituted part of the cost of manufacture and said amount was therefore properly deducted from its income as and for such cost of manufacture.

XII.

The wood stumpage cut and converted by Mitchell Bros. Co. during the year 1910 was owned by that company on December 31, 1908, and on January 1, 1909, and was at that time and during the years 1909 and 1910 of the fair market value of $4,379.25. Mitchell Bros. Co. was therefore entitled to deduct said amount of $4,379.25 from the net income for the year 1910—

First, because said wood stumpage was capital assets on December 31, 1908, and on January 1, 1909, and was not income within the meaning of the corporation excise tax law of August 5, 1909;

134 Second, because the cutting and conversion of said wood stumpage constituted a sale of the capital assets, and said amount was therefore properly deducted from income as and for restoration of capital assets;

Third, because the cutting and conversion of said wood stumpage constituted a depreciation of the capital assets of Mitchell Bros. Co., and said amount was therefore properly deducted from its income as and for depreciation of property;

Fourth, because the cutting and conversion of said wood stumpage constituted part of the cost of manufacture, and said amount therefore properly deducted from its income as and for such cost of manufacture.

XIII.

The wood stumpage cut and converted by Mitchell Bros. Co. during the year 1911 was owned by that company on December 31,

1908, and on January 1, 1909, and was at that time and during the years 1909, 1910, and 1911 of the fair market value of $5,454.75. Mitchell Bros. Co. was therefore entitled to deduct said amount of $5,454.75 from the net income for the year 1911—

First, because said wood stumpage was capital assets on December 31, 1908, and on January 1, 1909, and was not income within the meaning of the corporation excise tax law of August 5, 1909;

Second, because the cutting and conversion of said wood stumpage constituted a sale of the capital assets, and said amount was therefore properly deducted from income as and for restoration of capital assets;

Third, because the cutting and conversion of said wood stumpage constituted a depreciation of the capital assets of Mitchell Bros. Co., and said amount was therefore properly deducted from its income as and for depreciation of property;

Fourth, because the cutting and conversion of said wood stumpage constituted part of the cost of manufacture, and said amount was therefore properly deducted from its income as and for such cost of manufacture.

XIV.

The wood stumpage cut and converted by Mitchell Bros. Co. during the year 1912 was owned by that company on December 31, 1908, and on January 1, 1909, and was at that time and during the years 1909, 1910, 1911, and 1912 of the fair market value of $4,757.25. Mitchell Bros. Co. was therefore entitled to deduct said amount of $4,757.25 from the net income for the year 1912—

First, because said wood stumpage was capital assets on De-
135 cember 31, 1908, and on January 1, 1909, and was not income within the meaning of the corporation excise tax law of August 5, 1909;

Second, because the cutting and conversion of said wood stumpage constituted a sale of the capital assets, and said amount was therefore properly deducted from income as and for restoration of capital assets;

Third, because the cutting and conversion of said wood stumpage constituted a depreciation of the capital assets of Mitchell Bros. Co., and said amount was therefore properly deducted from its income as and for depreciation of property;

Fourth, because the cutting and conversion of said wood stumpage constituted part of the cost of manufacture, and said amount was therefore properly deducted from its income as and for such cost of manufacture.

XV.

The company's old office at Cadillac sold by Mitchell Bros. Co. during the year 1910 was owned by that company on December 31, 1908, and on January 1, 1909, and was at that time and during the years 1909 and 1910 of the fair market value of $5,000. Mitchell

Bros. Co. was therefore entitled to deduct said amount of $5,000 from the net income for the year 1910;

First, because said old office property was capital assets on December 31, 1908, and on January 1, 1909, and was not income within the meaning of the corporation excise tax law of August 5, 1909;

Second, because the sale of said old office property constituted a sale of the capital assets, and said amount was therefore properly deducted from income as and for restoration of capital assets;

Third, because the sale of said old office property constituted a depreciation of capital assets of Mitchell Bros. Co., and said amount was therefore properly deducted from its income as and for depreciation of property.

XVI.

The Grand Rapids real estate sold by Mitchell Bros. Co. during the year 1910 was owned by that company on December 31, 1908, and on January 1, 1909, and was at that time and during the years 1909 and 1910 of the fair market value of $700.00. Mitchell Bros. Co. was therefore entitled to deduct said amount of $700.00 from the net income for the year 1910;

First, because said Grand Rapids real estate was capital assets on December 31, 1908, and on January 1, 1909, and was not income within the meaning of the corporation excise tax law of August 5, 1909;

136 Second, because the sale of said Grand Rapids real estate constituted a sale of capital assets, and said amount was therefore properly deducted from income as and for restoration of capital assets;

Third, because the sale of said Grand Rapids real estate constituted a depreciation of the capital assets of Mitchell Bros. Co., and said amount was therefore properly deducted from its income as and for depreciation of property.

XVII.

The square timber products sold by Mitchell Bros. Co. during the year 1912 were owned by that company on December 31, 1908, and on January 1, 1909, and were at that time and during the years 1909, 1910, 1911, and 1912 of the fair market value of $5,957.57. Mitchell Bros. Co. was therefore entitled to deduct said amount of $5,957.57 from the net income for the year 1912;

First, because said square timber products were capital assets on December 31, 1908, and on January 1, 1909, and were not income within the meaning of the corporation excise tax law of August 5, 1909;

Second, because the sale of said square timber products constituted a sale of capital assets, and said amount was therefore properly deducted from income as and for restoration of capital assets;

Third, because the sale of said square timber products constituted a depreciation of the capital assets of Mitchell Bros. Co., and said amount was therefore properly deducted from its income as and for depreciation of property.

XVIII.

The cedar products sold by Mitchell Bros. Co. during the year 1912 were owned by that company on December 31, 1908, and on January 1, 1909, and were at that time and during the years 1909, 1910, 1911, and 1912 of the fair market value of $6,351.13. Mitchell Bros. Co. was therefore entitled to deduct said amount of $6,351.13 from the net income for the year 1912;

First, because said cedar products were capital assets on December 31, 1908, and on January 1, 1909, and were not income within the meaning of the corporation excise tax law of August 5, 1909;

Second, because the sale of said cedar products constituted a sale of capital assets, and said amount was therefore properly deducted from income as and for restoration of capital assets;

137 Third, because the sale of said cedar products constituted a depreciation of the assets of Mitchell Bros. Co., and said amount was therefore properly deducted from its income as and for depreciation of property.

C. W. Sessions,
District Judge.

Exceptions of defendant to the court's findings of fact, conclusions of law, and judgment herein.

Now comes the said defendant, by Myron H. Walker, United States attorney, and excepts to the finding of fact and conclusions of law of the district court as follows:

1. He excepts to the findings of the court in paragraph XIX of said findings of fact that the stump lands sold in the year 1909 "constituted part of its capital assets in December 31, 1908, and on January 1, 1909," in that there is no evidence to support or warrant such finding.

2. He excepts to the findings of the court in paragraph XX of said findings of fact that the stump lands sold in the year 1910 "constituted part of its capital assets on December 31, 1908, and on January 1, 1909," in that there is no evidence to support or warrant such finding.

3. He excepts to the findings of the court in Paragraph XXI of said findings of fact that the stump lands sold in the year 1911 "constituted part of its capital assets on December 31, 1908, and on January 1, 1909," in that there is no evidence to support or warrant such finding.

4. He excepts to the findings of the court in Paragraph XXII of said findings of fact that the stump lands sold in the year 1912 "constituted part of its capital assets on December 31, 1908,

118 and on January 1, 1909," in that there is no evidence to support or warrant such finding.

5. He excepts to the court's conclusion of law in Paragraph II of said conclusions that the sum of $2,732.02 was illegally assessed and unlawfully collected and that the plaintiff is therefore entitled to recover that sum with interest from its date of payment.

6. He excepts to the court's conclusion of law in Paragraph III of such conclusions that the plaintiff was entitled to deduct the amount of $109,997.04 from its net income for the year 1909 and that said stumpage was capital assets and not income and the cutting and conversion thereof constituted a sale of capital assets and the amount thereof was properly deducted from income as and for restoration of capital assets, and that the cutting and conversion thereof constituted a depreciation of the capital assets of plaintiff and was therefore properly deducted from its income and that the cutting and conversion thereof constituted part of the cost of manufacture and therefore was properly deducted from its income.

7. He excepts to the court's conclusion of law in Paragraph IV of said conclusions, that the plaintiff was entitled to deduct the amount of $104,088.33 from its net income for the year 1910 and that said stumpage was capital assets and not income and the cutting and conversion thereof constituted a sale of capital assets and the amount thereof was properly deducted from income as and for restoration of capital assets, and that the cutting and conversion thereof constituted a depreciation of the capital assets of plaintiff and was therefore properly deducted from its income and that the cutting and conversion thereof constituted part of the cost of manufacture and therefore was properly deducted from its income.

8. He excepts to the court's conclusion of law in Paragraph V of said conclusions that the plaintiff was entitled to deduct the amount of $88,903.56 from its net income for the year 1911, and that said stumpage was capital assets and not income and the cutting and conversion thereof constituted a sale of capital assets and the amount thereof was properly deducted from income as and for restoration of capital assets, and that the cutting and conversion thereof constituted a depreciation of the capital assets of plaintiff and was therefore properly deducted from its income and that the cutting and
119 conversion thereof constituted part of the cost of manufacture and therefore was properly deducted from its income.

9. He excepts to the court's conclusion of law in paragraph VI of said conclusions that the plaintiff was entitled to deduct the amount of $123,097.28 from its net income for the year 1912 and that said stumpage was capital assets and not income, and the cutting and conversion thereof constituted a sale of capital assets and the amount thereof was properly deducted from income as and for restoration of capital assets, and that the cutting and conversion thereof constituted a depreciation of the capital assets of plaintiff and was therefore properly deducted from its income and that the cutting and conversion thereof constituted part of the cost of manufacture and therefore was properly deducted from its income.

10. He excepts to the court's conclusion of law in paragraph VII of said conclusions that the plaintiff was entitled to deduct the amount of $8,607.11 from the net income for the year 1909 for the amount of stump land sold by plaintiff during that year and that said stump lands were capital assets and not income; that the sale of said stump lands constituted a sale of capital assets and the amount thereof was properly deducted from income as and for restoration of capital assets and that the sale of said stump lands constituted a depreciation of the capital assets of plaintiff and was properly deducted from income for depreciation of property.

11. He excepts to the court's conclusion of law in paragraph VIII of said conclusions that the plaintiff was entitled to deduct the amount of $3,284.01 from the net income for the year 1910, for the amount of the stump lands sold by plaintiff during that year and that said stump lands were capital assets and not income; that the sale of said stump lands constituted a sale of capital assets and the amount thereof was properly deducted from income as and for restoration of capital assets and that the sale of said stump lands constituted a depreciation of the capital assets of plaintiff and was properly deducted from income for depreciation of property.

12. He excepts to the court's conclusion of law in paragraph IX of said conclusions that the plaintiff was entitled to deduct the amount of $1,819.72 from the net income for the year 1911, for the amount of stump lands sold by plaintiff during that year and that said stump lands were capital assets and not income; that the
140 sale of said stump lands constituted a sale of capital assets and the amount thereof was properly deducted from income as and for restoration of capital assets and that the sale of said stump lands constituted a depreciation of the capital assets of plaintiff and was properly deducted from income for depreciation of property.

13. He excepts to the court's conclusion of law in paragraph X of said conclusions that said plaintiff was entitled to deduct the amount of $19,496.59 from the net income for the year 1912, for the amount of stump lands sold by plaintiff during the year and that said stump lands were capital assets and not income; that the sale of said stump lands constituted a sale of capital assets and the amount thereof was properly deducted from income as and for restoration of capital assets and that the sale of said stump lands constitute a depreciation of the capital assets of plaintiff and was properly deducted from income for depreciation of property.

14. He excepts to the court's conclusion of law in paragraph XI of said conclusions that the plaintiff was entitled to deduct the amount of $4,023.00 from its net income for the year 1909, for the amount of wood stumpage cut and converted by the plaintiff during the year 1909, and that said wood stumpage was capital assets and not income and that the cutting and conversion of said wood stumpage constituted a sale of the capital assets and was properly deducted from income for restoration of capital assets and that the cutting and conversion of said wood stumpage constituted a depre-

ciation of capital assets and was properly deducted from income for depreciation of property, and that the cutting and conversion of said wood stumpage constituted part of the cost of manufacture and the amount was properly deducted from income for such costs.

15. He excepts to the court's conclusion of law in paragraph XII of said conclusions that the plaintiff was entitled to deduct the amount of $4,379.25 from the net income for the year 1910 for the amount of wood stumpage cut and converted by the plaintiff during the year 1910, and that said wood stumpage was capital assets and not income and that the cutting and conversion of said wood stumpage constituted a sale of the capital assets and was properly deducted from income for restoration of capital assets and that the cutting and conversion of said wood stumpage constituted a depreciation of capital assets and was properly deducted from income for depreciation of property, and that the cutting and conversion of said
141 wood stumpage constituted part of the cost of manufacture and the amount was properly deducted from income for such costs.

16. He excepts to the court's conclusion of law in paragraph XIII of said conclusion that the plaintiff was entitled to deduct the amount of $5,454.75 from its net income for the year 1911 for the amount of wood stumpage cut and converted by the plaintiff during the year 1911, and that said wood stumpage was capital assets and not income and that the cutting and conversion of said wood stumpage constituted a part of the capital assets and was properly deducted from income for restoration of capital assets and that the cutting and conversion of said wood stumpage constituted a depreciation of capital assets and was properly deducted from income for depreciation of property, and that the cutting and conversion of said wood stumpage constituted part of the cost of manufacture and the amount was properly deducted from income for such costs.

17. He excepts to the court's conclusion of law in paragraph XIV of said conclusions that the plaintiff was entitled to deduct the amount of $4,757.25 from the net income for the year 1912 for wood stumpage cut and converted by plaintiff during the year 1912, and that said wood stumpage was capital assets and not income, and that the cutting and conversion of said wood stumpage constituted a sale of the capital assets and was properly deducted from income for restoration of capital assets and that the cutting and conversion of said wood stumpage constituted a depreciation of capital assets and was properly deducted from income for depreciation of property, and that the cutting and conversion of said wood stumpage constituted a part of the costs of manufacture and the amount was properly deducted from income for such costs.

18. He excepts to the court's conclusion of law in paragraph XV of said conclusions that the plaintiff was entitled to deduct the amount of $5,000 from the net income for the year 1910, for the amount for which the company's old office at Cadillac was sold by the plaintiff in the year 1910 and that said old office property was capital assets

and not income and that the sale of said old office property was a sale of capital assets and properly deducted from income for restoration of capital assets and that the sale of said old office property constituted depreciation of capital assets and was properly deducted from income for depreciation.

142 19. He excepts to the court's conclusion of law in paragraph XVI of said conclusions that the plaintiff was entitled to deduct the amount of $700 from the net income for the year 1910, for the amount for which the Grand Rapids real estate was sold by the plaintiff during the year 1910 and that the said Grand Rapids real estate was a sale of capital assets and properly deducted from income for restoration of capital assets and that the sale of said Grand Rapids real estate properly constituted depreciation of capital assets and was properly deducted from income for depreciation.

20. He excepts to the court's conclusion of law in paragraph XVII of said conclusions that the plaintiff was entitled to deduct the amount of $5,957.07 from the net income for the year 1912 for the amount of square timber products sold by plaintiff during the year 1912 and that said square timber products were capital assets and not income and that the sale of said square timber products was a sale of capital assets and properly deducted from income for the restoration of capital assets and that the sale of said square timber products constituted a depreciation of capital assets and was properly deducted from income for depreciation of property.

21. He excepts to the court's conclusion of law in paragraph XVIII of said conclusions that the plaintiff was entitled to deduct the amount of $6,351.13 from the net income for the year 1912 for the amount of cedar products sold by the plaintiff during the year 1912 and that the said cedar products were capital assets and not income and that the sale of said cedar products was a sale of capital assets and properly deducted from income for the restoration of capital assets and that the said cedar products constituted a depreciation of capital assets and was properly deducted from income for depreciation of property.

22. He excepts to the court's conclusion and direction that the plaintiff is entitled to judgment for the amount claimed.

23. He excepts to the judgment for the plaintiff herein in that the facts found do not support the judgment.

MYRON H. WALKER,
United States Attorney.

Inasmuch as the matters set forth in the foregoing bill of exceptions do appear of record, the district judge of the said district court of the United States for the western district of Michigan, southern division, at the request of the counsel for defendant, and after
143 due notice to plaintiff's attorneys, has settled this bill of exceptions, which contains the substance of all the evidence given upon the trial of said cause and the other proceedings had thereon.

Signed and settled October 25, 1915.

C. W. SESSIONS,
District Judge.

Assignments of error.

Filed October 25, 1915.

United States of America, District Court of the United States for the Western District of Michigan, Southern Division.

MITCHELL BROTHERS COMPANY, PLAINTIFF,

vs.

EMANUEL J. DOYLE, COLLECTOR OF INTERNAL REVENUE, DEFENDANT.

Assignments of error.

The defendant herein says that in the record, proceedings, findings, conclusions, refusals, and judgments of the court herein in favor of said plaintiff and against the said defendant, there is manifest error in this, to wit:

The court erred,

1st. In refusing to strike out of paragraph XIX of the findings of fact herein, the following: "Which constituted a part of its capital assets on December 31, 1908 and January 1, 1909," and to allow defendant's proposed amendment No. 7 to that effect.

2nd. In refusing to strike out of paragraph XX of the findings fact herein, the following: "Which constituted a part of its capital assets on December 31, 1908 and January 1, 1909," and to allow defendant's proposed amendment No. 8 to that effect.

3rd. In refusing to strike out paragraph XXI of the findings of fact herein, the following: "Which constituted a part of its capital assets on December 31, 1908 and January 1, 1909," and to allow defendant's proposed Amendment IX to that effect.

144 4th. In refusing to strike out of paragraph XXII of the findings of fact herein, the following: "Which constituted a part of its capital assets on December 31, 1908 and January 1, 1909," and to allow defendant's proposed amendment No. 10 to that effect.

5th. In refusing to allow defendant's proposed amendment No. 11 to such findings of fact, and to insert and find paragraph XXVIII-a, as therein requested.

6th. In refusing to allow defendant's proposed amendment No. 12 to such findings of fact, and to insert and find paragraph XXX-a, as therein requested.

7th. In refusing to strike out Conclusion of Law II as requested in defendant's proposed amendment 1 to such conclusion.

8th. In refusing to strike out Conclusion of Law III as requested in defendant's proposed amendment 1 to such conclusion.

9th. In refusing to strike out Conclusion of Law IV as requested in defendant's proposed amendment 1 to such conclusion.

10th. In refusing to strike out Conclusion of Law V as requested in defendant's proposed amendment 1 to such conclusion.

11th. In refusing to strike out Conclusion of Law VI as requested in defendant's proposed amendment 1 to such conclusion.

12th. In refusing to strike out Conclusion of Law XI as requested in defendant's proposed amendment 1 to such conclusion.

13th. In refusing to strike out Conclusion of Law XII as requested in defendant's proposed amendment 1 to such conclusion.

14th. In refusing to strike out Conclusion of Law XIII as requested in defendant's proposed amendment 1 to such conclusion.

15th. In refusing to strike out Conclusion of Law XIV as requested in defendant's proposed amendment 1 to such conclusion.

16th. In refusing to strike out Conclusion of Law XVII as requested in defendant's proposed amendment 1 to such conclusion.

17th. In refusing to strike out Conclusion of Law XVIII as requested in defendant's proposed amendment 1 to such conclusion.

18th. In refusing to allow defendant's proposed Conclusion of Law II in lieu of Conclusions II to VI, inclusive, XI to XIV, inclusive, and XVII to XVIII, inclusive, and to find and conclude as set forth in said proposed Conclusion II, as requested in defendant's said proposed amendment 1.

19th. In refusing to strike out Conclusion of Law VII as requested in defendant's proposed amendment 2 to such conclusion.

20th. In refusing to strike out Conclusion of Law VIII as requested in defendant's proposed amendment 2 to such conclusion.

21st. In refusing to strike out Conclusion of Law IX as requested in defendant's proposed amendment 2 to such conclusion.

22nd. In refusing to strike out Conclusion of Law X as requested in defendant's proposed amendment 2 to such conclusion.

23rd. In refusing to allow defendant's proposed Conclusion of Law III in lieu of said Conclusions VII to X inclusive, and to find and conclude as set forth in said proposed Conclusion III, as requested in defendant's said proposed amendment 2.

24th. In refusing to strike out Conclusion of Law XV as requested in defendant's proposed amendment 3 to such conclusion.

25th. In refusing to strike out Conclusion of Law XVI as requested in defendant's proposed amendment 3 to such conclusion.

26th. In refusing to allow defendant's proposed Conclusion of Law IV in lieu of said Conclusions XV and XVI and to find and conclude as set forth in said proposed conclusion as requested in defendant's proposed amendment 3.

27th. In refusing to allow defendant's Conclusion of Law V and to find and conclude as therein set forth as requested in defendant's proposed amendment IV.

28th. In Findings of Fact XIX, XX, XXI, and XXII that the stamp lands constituted part of plaintiff's capital assets on December 31, 1908, and on January 1, 1909. (Ex. 1, 2, 3, and 4 to findings.)

145

20th. In Conclusion of Law II that the sum of $2,732.02 w illegally assessed and unlawfully collected. (Ex. 5.)

30th. In Conclusion of Law III that the plaintiff was entitled deduct the amount of stumpage cut to the amount of $109,927. from its net income for the year 1909. (Ex. 6.)

31st. In Conclusion of Law IV that the plaintiff was entitl

148 to deduct the amount of stumpage cut to the amount $104,036.36 from its net income for the year 1910. (Ex. 7.)

32nd. In Conclusion of Law V, that the plaintiff was entitled deduct the amount of stumpage cut to the amount of $83,903.16 fr its net income for the year 1911. (Ex. 8.)

33rd. In Conclusion of Law VI that the plaintiff was entitled deduct the amount of stumpage cut to the amount of $132,097.28 fr its net income for the year 1912. (Ex. 9.)

34th. In Conclusion of Law VII, VIII, IX, and X that the plai tiff was entitled to deduct $6,607.11, $8,264.01, $1,819.72, a $19,466.59 from its net income for the years 1909, 1910, 1911, a 1912, respectively, for the amount of stump lands sold in those yea (Ex. 10 to 13.)

35th. In Conclusions of Law XI, XII, XIII, and XIV that plaintiff was entitled to deduct the amounts of $4,023.60, $4,579. $5,454.75, and $4,787.28 from its net income for the years 1909, 19 1911, and 1912, respectively, for the amount of wood stumpage s in those years. (Ex. 14-17, inc.)

36th. In Conclusion of Law XV that the plaintiff was entitled deduct the amount of $6,000 from its net income for the year 19 for the amount realized from the sale of old office property in th year. (Ex. 18.)

37th. In Conclusion of Law XVI that the plaintiff was entitled deduct the amount of $700.00 from its net income for the year 19 for the amount realized from the sale of Grand Rapids real est in that year. (Ex. 19.)

38th. In Conclusion of Law XVII that the plaintiff was entit to deduct the amount of $6,997.07 from its net income for the y 1912 for the amount of square timber products sold in that ye (Ex. 20.)

39th. In Conclusion of Law XVIII that the plaintiff was entit to deduct the amount of $6,951.18 from its net income for the y 1912 for the amount of cedar products sold in that year. (Ex. 2

40th. In concluding that the plaintiff is entitled to judgm against the defendant for the amount claimed and in the award and rendition of the judgment herein in favor of said plaintiff a against the said defendant. (Ex. 22 to 30.)

Dated, October 22nd, 1915.

Miner H. Warren,
United States Attorney

147 *Petition of writ of error.*

Filed October 25, 1915.

United States of America, in the District Court of the United States for the Western District of Michigan, Southern Division.

MITCHELL BROTHERS COMPANY, PLAINTIFF,
vs.
EMANUEL J. DOYLE, COLLECTOR OF INTERNAL REVENUE, fourth district, defendant.

Now comes Emanuel J. Doyle, collector of internal revenue, by Myron H. Walker, United States attorney for the Western District of Michigan, and says that on the 18th day of March, A. D. 1915, at the March term, 1915, of said court, a trial was had in said court, without a jury, said jury having been duly waived by stipulation of the parties to said cause, on a declaration representing a cause of action against this defendant for the purpose of recovering certain corporation income taxes theretofore paid under protest by said plaintiff to the predecessor in office of said defendant as collector of internal revenue for the fourth collection district of Michigan, which trial resulted in a judgment rendered by said court on the 1st day of May, A. D. 1915, in favor of said plaintiff.

In which trial findings of fact and conclusions of law, judgment, and proceedings had therein in this cause certain errors were committed to the prejudice of said defendant, all of which will more fully and in detail appear in the bill of exceptions and assignments of error which are presented with this petition, the same having been duly filed with the clerk.

Wherefore, the said Emanuel J. Doyle, collector as aforesaid, the defendant herein, prays that a writ of error may issue in his behalf to the United States Circuit Court of Appeals for the Sixth Circuit for the correction of the errors so complained of and that a transcript of the records, proceedings, and papers in this cause, duly authenticated, may be sent to the said Circuit Court of Appeals for review.

MYRON H. WALKER,
United States Attorney.

Let a writ of error issue pursuant to the prayer of the foregoing petition.

C. W. SEVERENS,
Judge of the District Court of the United States for the Western District of Michigan.

148 *Writ of error.*

United States Circuit Court of Appeals for the Sixth Circuit.

UNITED STATES OF AMERICA,
Sixth Judicial Circuit, ss:

The President of the United States to the honorable the judge of the District Court of the United States for the Western District of Michigan, Southern Division, greeting:

Because in the record and proceedings, as also in the rendition of the judgment of a plea which is in the said district court, before you, between Mitchell Brothers Company, plaintiff, and Emanuel J. Doyle, collector of internal revenue, defendant, a manifest error hath happened to the great damage of the said defendant as by his complaint appears. We being willing that error, if any hath been, should be duly corrected and full and speedy justice done to the parties aforesaid in this behalf, do command you, if judgment be therein given, that then under your seal, distinctly and openly, you send the record and proceedings aforesaid, with all things concerning the same, to the United States Circuit Court of Appeals for the Sixth Circuit, together with this writ, so that you have the same at Cincinnati, in said circuit, on the 24th day of November next, in the said Circuit Court of Appeals, to be then and there held, that the record and proceedings aforesaid being inspected the said Circuit Court of Appeals may cause further to be done therein to correct that error, what of right, and according to the laws and customs of the United States, should be done.

Witness the Honorable Edward D. White, Chief Justice of the United States, the 25th day of October, in the year of our Lord one thousand nine hundred and fifteen and of the independence of the United States of America the one hundred and fortieth.

[Seal.] CHAS. J. POTTER,
Clerk of the District Court of the United States for the Western District of Michigan.

Allowed by
C. W. SESSIONS,
District Judge.

149 *Citation.*

United States Circuit Court of Appeals for the Sixth Circuit.

UNITED STATES OF AMERICA,
Sixth Judicial Circuit, ss:

To Mitchell Brothers Company, Greeting:

You are hereby cited and admonished to be and appear at a session of the United States Circuit Court of Appeals for the Sixth Circuit

to be holden at the city of Cincinnati, in said circuit, on the 24th day of November next, pursuant to a writ of error filed in the clerk's office of the District Court of the United States for the Western District of Michigan, Southern Division, wherein Emanuel J. Doyle, collector of internal revenue, is plaintiff in error, and you are defendant in error, to show cause, if any there be, why the judgment rendered against the said plaintiff in error, as in the said writ of error mentioned, should not be corrected, and why speedy justice should not be done to the parties in that behalf.

Witness the honorable Edward D. White, Chief Justice of the United States, this 25th day of October, in the year of our Lord one thousand nine hundred and fifteen, and of the Independence of the United States of America the one hundred and fortieth.

C. W. Sessions,
U. S. District Judge.

Due personal service of a copy of the above citation admitted this 25th day of October, A. D. 1915.

Norris, McPherson, Harrington & Ware,
Attorneys for Defendant in Error.

Precipe for transcript.

Filed November 3, 1915.

In the District Court of the United States for the Western District of Michigan, Southern Division.

Mitchell Brothers Company

vs.

Emanuel J. Doyle, as United States collector of internal revenue for the fourth collection district of Michigan.

150 To the clerk of said court: You may include the following in the record in the above entitled cause: Declaration, plea, opinion of court, judgment entered, bill of exceptions, assignments of error, petition for writ of error, writ of error, citation and acceptance of service.

And such other journal entries as in your judgment are absolutely necessary. I know of none, unless it be orders extending time to settle bill of exceptions, etc.

Dated, Grand Rapids, Michigan, November 2, 1915.

Myron H. Walker,
United States Attorney.

Clerk's certificate.

UNITED STATES OF AMERICA,
Western District of Michigan, Southern Division, ss:

I, Charles J. Potter, clerk of the United States District Court for the Western District of Michigan, do hereby certify that the foregoing are true and compared copies of the declaration and rule to plead, plea, opinion, bill of exceptions, assignments of error, petition for writ of error and precipe for transcript filed in said cause and of the judgments and orders extending time entered therein, omitting such portions thereof as are required by Rule 15 of the United States Circuit Court of Appeals for the Sixth Circuit to be omitted, to which I have attached the original writ of error and citation in said cause; the whole constituting my return to the writ of error in said cause as made up pursuant to the directions in said precipe of attorneys for plaintiff in error.

And I further certify that no precipe for transcript on the part of the defendant in error has been filed in said cause.

Witness my hand and the seal of said court at the city of Grand Rapids in said district and division, this 15th day of November, in the year of our Lord one thousand nine hundred and fifteen.

[Seal.] CHAS. J. POTTER, *Clerk.*
By CHAS. L. FITCH, *Deputy.*

151 *Proceedings in the United States Circuit Court of Appeals for the Sixth Circuit.*

Cause argued and submitted (April 4th, 1916, before Knappen, Denison, and Evans, JJ.).

This cause is argued by Mr. Myron H. Walker, United States Attorney for the plaintiff in error, and by Mr. Mark Norris and Mr. Oscar E. Warr for the defendant in error, and is submitted to the court.

Judgment (filed June 30, 1916).

Error to the District Court of the United States for the Western District of Michigan. This cause came on to be heard on the transcript of the record from the District Court of the United States for the Western District of Michigan, and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this court that the judgment of the said district court in this cause be, and the same is hereby, affirmed without costs.

152 Opinion (filed July 1, 1916).

No. 2964.

United States Circuit Court of Appeals, Sixth Circuit.

EMANUEL J. DOYLE, COLLECTOR OF INTERNAL REVENUE, plaintiff in error, vs. MITCHELL BROTHERS COMPANY, Defendant in error.	Error to the District Court of the United States for the Western District of Michigan.

Submitted April 4, 1916. Decided June 30, 1916.

Before Knappen and Denison, circuit judges, and Evans, district judge.

DENISON, circuit judge: Mitchell Brothers Company, a Michigan corporation, acting pursuant to the corporation tax law of 1909 (36 S. L. 112, ch. 6, sec. 38), made an income return and paid the tax due thereunder. Later the Commissioner of Internal Revenue, after an investigation, raised the figures of income return and assessed an additional tax. The company paid under protest, and this action was brought in the court below to recover the amount so paid. The case was tried without a jury, and the district judge made
153 special findings of fact and of law, and rendered judgment for plaintiff. The collector alleges error.

Several items are involved, but all depend upon the same principles, and we state one only, and, for simplicity in figures of acreage instead of per thousand feet of lumber. The plaintiff corporation was organized in 1903. Its capital stock was represented mainly by timber lands entered on the books at their purchase price. This standing timber, or stumpage, than had a market value of $20 per acre, and it was taken in as capital at this figure. Owing to the market increase in stumpage prices, and to new methods of using much stumpage formerly wasted, the market price of such standing timber had become, on December 31, 1908, $40 per acre. No entry was ever made on the books representing this increase in value, but each year the company entered on its books as a profit the difference between the original cost $20 and the sums received for the manufactured product cut from an acre, less the cost of manufacture, and the profits so seeming to accrue were either paid out in dividends or carried into the surplus account. After the pas-
154 sage of this tax law, in August, 1909, and preparatory to making the income return for 1909, the company revalued this stumpage, as of December 31, 1908, and fixed that value at (about) $40 per acre. The good faith and accuracy of this valuation are not questioned. It was made upon the basis of price per thousand, but the figures so reached were never entered in the corporate books of the company and never affected the showing of profits made

thereon. In making its return for 1909, and in stating net income, the company deducted from the proceeds of lumber sold this sum of $40; but the commissioner restored $20 of that amount and held that the only deduction authorized by the law was the $20 which had been originally entered and which had been carried on the account books as the cost of the stumpage. The decisive question here is whether the $20 difference—the additional value of the timber which had accrued before 1909 but had not been entered on the books—was taxable income for 1909. The amount of the tax so in dispute for the four years 1909–1912, is $2,732, with interest at five per cent from December 22, 1913, the date when payment under protest was made.

The collector insists that the net income taxable under this law is a different thing from profits, and complains that the dis-
155 trict judge overlooked the distinction. The statute refers to "net income," but it expressly provides for deducting certain items from the gross income, and whether the residuum does or does not substantially differ from what are commonly called profits is an academic question in this case. It makes no difference what name is given to the net sum which thus becomes taxable. The collector also urges that the "income received," named in the statute, must be defined with specific reference to the word "received."

It is clear that, by the term "income," Congress did not intend to include the proceeds of capital assets sold or converted during the year; nor can it be material whether such proceeds are reinvested in other property or remain in the treasury of the company or are distributed to the stockholders; nor whether, in case of such distribution, they are called dividends or capital. The controlling question must be whether assets so converted were, in fact, at the beginning of the tax period properly to be classed as capital assets. If they were of that character they cannot be "income" received during the later period; they represent merely capital in a changed form.[1] If an illustration were needed to show that money received from
156 selling capital assets cannot be "income," it would be found in the statutory treatment of insurance money. A loss suffered during the year may be deducted from income, but not so if the loss was compensated by insurance. Fire insurance money is clearly a substitute for the assets burned; but we find that in case of a fire loss uninsured the loss may be deducted from income; while if it is insured and if the insurance money is "income" the loss may not be deducted and the insurance money must be added—an absurdity

[1] Treasury Decision No. 1606, March 29, 1910, sec. 76: "Removal of timber from timber lands, while depleting the lands to the extent of such removal, is regarded as a change in the form of assets and not a depreciation within the meaning of the act."

Treasury Decision No. 1875, February 14, 1911, sec. 75: "The mere removal of timber by cutting from timber lands, unless the timber is otherwise disposed of through sales or plant operations, is considered simply a change in form of assets. If said timber is disposed of through sales or otherwise it is to be accounted for in accordance with regulations governing disposition of capital and other assets."

which can be avoided only by saying that such insurance money is not income at all. The proceeds of the sale of a building or other permanent assets are as clearly a substitute therefor as is the insurance money paid to indemnify for a building burned.

Indeed, no one disputes the proposition in its broadest aspect that the selling price of capital assets is not "income"; the assessment made by the Commissioner of Internal Revenue and here involved goes upon the theory that it is right to deduct the proceeds of such assets from the receipts of the year before ascertaining net income; but the only controversy is as to the proper definition of those capital assets which are to be thus excluded.

157 It is equally clear, to us, that "income" is not limited to cash receipts. Of course, the word is capable of this restricted meaning, and any number of interesting problems can be evolved through nice refinements in the precise meaning of "income," "received," "depreciation," "actually paid," and other statutory words, but this law was passed to make a workable system of raising revenue and not to provide exercise in dialectics. The theory which should undertake to consider only the cash received during the year for property sold and then to ascertain the cost of each item so sold, no matter whether produced during the year or long before, would, in the ordinary, typical manufacturing or merchandising business, be impossible of intelligent application. "Income received" need not be in cash. If, in the regular course of business, the property has been sold and is represented by a bill or account receivable, it is no undue stretch of language to say that these proceeds are income received. It is only a step further in the same line to say that property, regularly on hand for sale at the end of the year and which has an ascertainable market value, realizable at the owner's option, has been "received" by the business and should enter into a computation of income. Otherwise, a business which had been very

158 profitable but in which the bulk of the annual output was being held at the close of the year for a further market rise would have no income at all. Indeed, in the present case, that part of the computation upon which the taxpayer and the commissioner and the collector's counsel all unite, for ascertaining income, includes, as a part of the income for 1909, more than $300,000 for lumber in the yard unsold at the end of the year, and the elimination of this item would wipe out all net income several times over. Doubtless, there may be difficulties in making the proper appraisal of property on hand. Perhaps it should be listed at market price less cost of sale; or, perhaps, at cost of production, because the element of gain or loss reached by comparison with market selling price may be too contingent to justify a permanent taking over into the accounts; but these are practical questions and they can be met in a practical way. Those business enterprises which the law affects have well-known methods and customs for meeting these problems, and have no difficulty in finding the gains or profits or income, or whatever they may be called, which have been received, and stating them surely

enough and definitely enough to form an acceptable basis for
159 the declaration and payment of dividends in a corporation,
or for affecting and fixing the selling price of corporate stock
or of any and every going business enterprise; and the use of the
same methods, in good faith, will easily determine the taxable "net
income" of such an enterprise as this.

If property on hand at the end of the year, figured at its true inventory or market value, must be put upon one side of the income account, there can be no escape from putting the corresponding true value at the beginning of the year upon the other side of the account; and this must include the raw materials which were on hand at the beginning. The law contemplates distinct periods. Everything before 1909 must be in one period; everything later in another; and then, for taxing purposes, each calendar year after that date forms a distinct sub-period; the law plainly contemplates that all income shall be definitely located somewhere. The law applied to and took effect upon business conducted after January 1st, 1909; business is conducted with property; and so the law took effect upon the body of property existing at that date and upon the business
thereafter conducted by and with the aid of that body of prop-
160 erty. In the later successive years, and as to some classes of
property, it may serve every purpose to delay the computation or entry of income or gains seemingly existing in one year until cash realization in the next, and to do this by carrying an arbitrary but constant inventory value; this will make no difference to taxpayer or to the Government in the end; but not so with reference to the two main periods before and after the law took effect. In the sense in which we have seen "income" is and must be used at the end of each taxing year, it must be used at the end of the period preceding 1909. Whatever would be income for 1909 if it accrued after January 1st had become income on that day if it had accrued in the earlier period.

The practical necessity of including a comparison between beginning and ending period price inventories, as an element in computing net income, is further illustrated by the provision as to "depreciation." This may be deducted; a drop in market prices provides the commonest instance of loss by depreciation; but unless there is a beginning appraisal, there is nothing from which to compute the loss. So, too, if a loss by depreciation is to be deducted, a gain by
appreciation must be added; otherwise the taxpayer would
161 get permanent credit for a loss which might be temporary.
A fall in market price in December, followed by an equivalent rise in January, ought not to diminish the taxable income for the two years; but it would do so if property on hand is to be considered at all and if the loss the first year is deducted and the later gain not added.

The true character of that particular accumulation on January 1st, 1909, now involved, may be illustrated with reference to this corporation. To meet this $90 per acre increase in market value the com-

pany could lawfully have paid out a cash dividend or a stock dividend, or it could have sold its property for the original value plus the appreciation and have distributed the entire proceeds. If this had been done on December 31st, 1908, there would be no income in 1909. If the consummation were postponed for two days, upon no tenable theory could it be thought that the $20 appreciation would become part of the income produced by carrying on the business during 1909. We are satisfied that the necessary and practical working of the law requires, and that its words fairly permit, income for one year to be computed by the aid of a comparison between the market value of the body of property on hand at the beginning
162 and at the end of the year; and it follows that such a market value of property existing at the commencement of the period must be deducted from the selling price afterwards received. We are speaking only of those business assets the manufacture and sale or the purchase and sale of which constitute the regular business which is being measured for taxation purposes—assets which were acquired and held for sale and are intended to be sold as soon as put in the selected selling form. Appreciation in assets intended for more permanent holding may or may not be governed by the same considerations.

Counsel for the collector takes something from the fact that income is not here taxed as such, but is used only as a convenient measure of determining the amount of business done, upon the doing of which business the excise tax is imposed. This is not controlling; it leads as well to the other conclusion. In such a business enterprise as this, the manufacturing of the raw material and putting it into ultimate salable form is much the greater fraction of the business done and receiving the protection of the laws; the final converting of the product into cash is much less; and "income" cannot be
163 made the measure of this greater fraction unless by the aid of comparing the body of property on hand at the beginning and at the end of the period. If the receipt of money for sales was the measure of income and so of volume of business the taxpayer could evade taxation by ceasing sales and accumulating stock as the law was repealed and the end of the taxing period approached, or by abnormally ceasing manufacture and reducing stock in anticipation of the taking effect of the law.

There are three possible methods of treating such a business as this: (1) We may say that there is no income whatever, since the sale of capital assets determines their value in the raw material form and so nothing has been received except their fair price; (2) we may say that the entire selling price of the assets is income when the money is received; or (3) we may say that the appreciation therein and gain thereupon during the period and found at its end in realizable form is income. The first or second definition conform rather better to the ordinary meaning of the word, but they cannot be accepted. The first was held, in Stratton's Independence v. Howbert, 231 U. S., 399, to be erroneous and to involve a misapplication of Gray v. Darlington,

39 U. S., 43. The second is in conflict with the unbroken
184 practice of the Treasury Department in administering this law[1] and in conflict with the assessment made by the commissioner in this case, and we have pointed out some of the reasons why it cannot have been intended by Congress to be applicable to this kind of a business. The third is workable and practicable and, as we think, the only fair interpretation.

Counsel for the collector rely upon a number of cases, mostly English,[2] to support the proposition that where the business which is being carried on contemplates and necessarily involves a wasting of the capital assets, the proceeds of that wasting are entirely income. Of these cases it is to be noticed that they are mostly mining cases, and that mineral, out of sight in the ground, forms a peculiar class of capital assets. It has no market value because it cannot be measured, and neither quantity nor quality can be definitely known. It is predominantly speculative, and the difficulty of determining what is capital and what is income is very great; while this standing timber had at all times an easily ascertainable market price. In so far as these cases hold that the entire capital so realized is necessarily income they are in conflict with Stratton's Independence v. Howbert, supra, since the latter case expressly recognizes that a
185 suitable allowance for depreciation or consumption of ore in the ground should be made and the Treasury Decisions 1668, 1675, 1742, 1754, 1755, 1832 have provided practicable systems for computing such allowance. It is to be further noticed regarding these cases that they depend upon the exact words of the particular statutes, differing materially from the statute here involved, and that to these statutes the considerations above stated and which we have thought controlling may not and probably do not apply.[3]

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[1] Treasury Decision No. 1871, December 2, 1908, sec. 5: "* * * It is immaterial whether any item of gross income is evidenced by cash receipts during the year or in such other manner as to entitle it to proper entry on the books of the corporation from January 1 to December 31 for the year in which return is made. * * * If the capital assets were acquired prior to January 1, 1909, the amount of increment or depreciation representing the difference between the selling and buying price is to be adjusted so as to fairly determine the proportion of the loss or gain arising subsequent to January 1, 1909, and which proportion of the loss or gain arising subsequent to January shall be deducted from or added to the gross income for the year in which the sale was made."

Treasury Decision No. 1938, January 24, 1910, sec. 2: "In making up the gross income to be reported in item 3 the cost of the goods manufactured shall be ascertained by the addition of a charge to the account of the cost of the goods as manufactured during the year of the sum of the inventory at the beginning of the year, and a credit to the account of the sum of the inventory at the end of the year."

Treasury Decision No. 1742, December 5, sec. 23: "In the case of lands bought prior to January 1, 1909, and sold during any subsequent year, the profits arising from such sale, if no accounting of increased value of land was made in return for previous years, should be prorated in accordance with the number of years the land was held by the corporation and the number of years the law was effect."

[2] Stevens v. Hudsons Bay Co., 181 L. T., 98; Lee v. Asphalt Co., 41 Ch. Div. 11; Coltness Co. v. Black, 6 App. Cas., 315; Kauri Timber Co. v. Commissioner, 1913, App. Cas., 771.

[3] (e. g.) In Kauri Co. v. Commissioner, the statute said: "No deduction shall be made in respect of * * * expenditures of capital, loss of capital, capital withdrawn.

There is nothing magical in bookkeeping; it does not create facts; it only records them. A citizen cannot be rightly taxable in one way if he keeps books and in another way if he keeps none; nor in one way, if his books are accurate and kept up to date, and in another way if they are imperfect and neglected. Book entries may be of value as an admission when a tax is to be assessed and when there is a dispute as to the fact, but they cannot work an estoppel as to an undisputed fact.[1] The insistence of the commissioner for this $90 per acre appreciation is income for the year in which the timber happens to be cut, rests at last upon the theory that the taxpayer is estopped to claim that it was income for an earlier period be-
166 cause he had not so entered it on his books; and this theory we cannot accept. Its formal transfer into surplus or undivided profits account would have done nobody any good or any harm. Until this law was passed, it was a matter of indifference to the corporation and to the stockholders whether profits were entered up at one time or another, and any attempt after August, 1909, to make a book entry of these gains, nunc pro tunc, as of December, 1908, would only have invited adverse comment.

On this subject, there cannot be one rule for a corporation and another for an individual. If this property had continued to be owned by the partnership which preceded the corporation, there might have been no capital account representing the land and timber. The existence or not of such an account would have been incidental to the bookkeeping system adopted. It is only the existence of the capital stock of the corporation which compels the maintenance of an account showing the corresponding assets. So, we find ourselves unable to give any controlling force to the fortuitous circumstance that in this case the capital account was carried under the name of "Land and Timber," and that the accretions had not been entered.

167 We find no authority precisely in point. In Gray v. Darlington, supra, and in numerous cases which have followed that decision, including Gauley Co. v. Hayes (C. C. A. 4), 220 Fed. 110, the precise point involved was whether the entire profit made by a stockholder or bondholder in a corporation, upon a sale of his stock or bonds, as compared with the original purchase price, was income apportionable solely to the year of sale. It was held that this profit was not such income. These cases are not necessarily, if at all, inconsistent with some reasonable apportionment to the taxing period of that part of the profit which accrued during that period; and certainly, since the question now involved is not the income of the stockholder or bondholder on his investment, but the income of the corporation which issues the stock or bonds, these cases do not conflict at all with our conclusion that the body of property of such a corporation, at the beginning and at the end of the period, should be compared as one of the steps to ascertain that net income which

[1] See comments by Lacombe, C. J., in U. S. v. Nipissing Co., 202 Fed. 893, 894, and by Dickinson, D. J., in Baldwin v. McCoach, 215 Fed. 967, 970.

is merely a measure of volume of business. The same thing is true of those decisions[a] which, as between life tenant and remainderman, classify a dividend when it is received by the stockholder as a part of this income rather than as a part of the principal fund, even though it may include a capital distribution. In Baldwin v. McCoach (C. C. A. 3), 221 Fed. 59, we find a state of facts similar to that here involved in one respect. Capital assets which existed January 1st, 1909, had never been entered on the books at all. They were appraised and so entered during the year 1909. It was held that they did not thereby become part of the income for that year. The reasoning of the district judge, affirmed by the Circuit Court of Appeals, is to the effect that the matter of entering or not upon the corporate books is of no importance as against the truth. Whether an actual change in value of these assets, occurring during the year 1909, might rightfully have been taken into account, either as increase or decrease, was not involved.

The judgment of the court below is affirmed, but without costs.

Petition for rehearing.

(Filed July 27, 1916.)

In the United States Circuit Court of Appeals for the Sixth Circuit.

EMANUEL J. DOYLE, COLLECTOR OF INTERNAL REVENUE, PLAINTIFF IN ERROR,
vs.
MITCHELL BROTHERS COMPANY, DEFENDANTS IN ERROR. } No. 2664

Error to the District Court of the United States for the Western District of Michigan.

Petition for rehearing.

Emanuel J. Doyle, collector of internal revenue of the fourth collection district of Michigan, plaintiff in error herein, comes now by Myron H. Walker, United States attorney, acting in his behalf, and conceiving that the court in affirming the judgment of the trial court herein, is in error, and that a rehearing of this cause should be granted and had for the following reasons:

1. That the court in its opinion filed herein, and in affirming said judgment, does not make clear the ground upon which its decision is based and the judgment of the court below affirmed, in that it is impossible to determine from the opinion of the court whether this court holds and intends to hold that the $30 per acre appreciation in value of the timber lands of defendant in error from its organization in 1903 to the 31st of December, 1908, is or is not

[a] e. g. Oliver's Appeal, 126 Pa. St., 48; Clark & Marshall, p. 1031.

income at all, or for any purpose, within the meaning of the excise corporation tax act.

2. It is impossible to determine from such opinion whether the court holds or intends to hold that the said amount of appreciation per acre in the timber lands of the defendant in error if income within the meaning of said excise corporation tax act, or for any of the purposes thereof, may be deducted from such income as and for depreciation within the meaning of such act.

And as your petitioner is advised and believes it is most important that the exact ground upon which the decision of this court is placed in this regard, should be made plain and put beyond question, both because of the importance of the issues and question involved in the case and for purposes of further proceedings therein, and the possible review of such decision.

3. Because the court is in error in its determination of what constitutes and is income, and what constitutes and is capital and capital assets, so called, within the terms and meaning of such act.

4. Because the court is in error in its holding that the case of Stratton's Independence v. Howbert, 231 U. S. 399, holds or undertakes to determine that a suitable allowance for depreciation for consumption of ore in the ground should be made under the excise corporation tax act for the reason that the statement of the court upon that point is mere dictum.

5. Because the court states (Op. p. 2) that "the decisive question here is whether the $20 difference—the additional value of the timber which had accrued before 1909, but had not been entered on the books—was taxable income for 1909." But it is admitted by the Government that "value of timber," i. e., "capital," can never
171 be taxed as "income." The question before the court, therefore, was (1) whether the proceeds of sale of the lumber manufactured from the timber was "income," and (2) whether, if it was, the depletion of capital to the extent of $20 per acre could be deducted as depreciation. The court misconstruing the distinction between "capital" and "income," naturally misstated the question before it.

6. Because the court stated (Op. p. 3) that "it is clear that, by the term 'income,' Congress did not intend to include the proceeds of capital assets sold or converted during the year." But the "income" of every merchant is simply made up of the various items of proceeds of sale of capital assets, namely, his stock of goods and the contrary of the court's position is assumed by the Supreme Court in Stratton's Independence v. Howbert, 231 U. S., bottom page 414, top page 415.

7. Because the court says (Op. p. 3), "Indeed, no one disputes the proposition, in its broadest aspect, that the selling price of capital assets is not 'Income.'" But the Government does dispute it most vigorously and therefore it is clear that the court did not understand the Government's position. "Income" simply means the services rendered by "capital" to its owner over a certain period of time.

The money received by the butcher for his meat, by the baker for his bread, by the merchant for his goods, all are the services rendered by his "capital" and are therefore his "income." Equally the proceeds of sale of the lumber of a mill company is the "income" of that company. There can be no "income" without a use of "capital assets."

8. Because the court states (Op. p. 5), the question before it to be to determine "the taxable" net income "of such an enterprise as this." But this view is repudiated in Anderson v. The Forty-two Broadway Co., 239 U. S., 69, where the Supreme Court held
172 that the thing to determine was "the gross amount of income received within the year from all sources," and then in order to arrive at "net income" to deduct those items and those items only which the act expressly specified as allowable deductions.

9. Because the court adopts as its conclusion (Op. p. 7), "that the appreciation thereon" (namely, capital assets) "and gain thereupon during the period and found at its end in realizable form is income." But "appreciation" in "capital" is still "capital" and can never be "income"; while "gains" means nothing since the word is not used in the act. The above quotation therefore shows both a misconstruction of the distinction between "capital" and "income," as also a failure to realize that the first and all-important object to be determined is "the gross amount of income received from all sources."

10. Because throughout the opinion of the court and especially in its treatment of "inventories" there runs the idea that the Treasury rulings on the subject involved have made an authoritative departmental construction of the terms "capital" and "income." But the law department of the Government has always denied the correctness of these rulings when opportunity to do so arose, and notably in the Stratton's Independence case. The law department has no jurisdiction over the assessment made by the Commissioner of Internal Revenue and when the plaintiff is merely claiming that the ruling of the Commissioner in making it was not favorable enough to the plaintiff the Government has no object in claiming that it was too favorable. Such rulings, however, have never established an accepted departmental construction.

Wherefore, your petitioner prays that this court may grant
173 a rehearing of this cause and may grant the said plaintiff in error relief in the particulars above mentioned and such other and further relief as shall be found to be in accordance with his just rights under the law.

MYRON H. WALKER,
United States Attorney for Petitioner.

UNITED STATES OF AMERICA,
Western District of Michigan, Southern Division, ss:

I, Myron H. Walker, United States attorney for the said western district of Michigan, do hereby certify that the foregoing application for rehearing is made in good faith under instructions of the Attorney General of the United States and that in my judgment the

petition is well founded and there is substantial reason therefor. And I further certify that the same is not filed for purpose of delay.

Dated, July 25, 1916, Grand Rapids, Mich.

MYRON H. WALKER,
United States Attorney.

174 Order denying petition for rehearing (filed Feb. 16, 1917).

Petition for rehearing filed in this cause is hereby denied.

Opinion on petition for rehearing (filed Feb. 16, 1917).

175 No. 2864.

United States Circuit Court of Appeals, Sixth Circuit.

EMANUEL J. DOYLE, COLLECTOR, PLAINTIFF IN ERROR,
vs.
MITCHELL BROS. COMPANY, DEFENDANT IN ERROR.
} On motion for rehearing.

February 16, 1917.

Per curiam: We have held the application for rehearing in the expectation that the decision of the Supreme Court in Von Baumbach v. Sargent, might affect the reasoning or the conclusions of our opinion in this case. The opinion in that case was announced on January 15, 1917. It does not consider those features of the case that are here involved and so does not add to the existing knowledge on those subjects.

The merits of the petition have been considered, and we are not convinced that there was any substantial error in the opinion.

The petition is denied.

176 United States Circuit Court of Appeals for the Sixth Circuit.

I, William C. Cochran, clerk of the United States Circuit Court of Appeals for the Sixth Circuit, do hereby certify that the foregoing is a true and correct copy of the record and proceedings in the case of Emanuel J. Doyle, collector, etc., *vs.* Mitchell Brothers Company, No. 2864, as the same remains upon the files and records of said United States Circuit Court of Appeals for the Sixth Circuit, and of the whole thereof.

In testimony whereof I have hereunto subscribed my name and affixed the seal of said court at the city of Cincinnati, Ohio, this 14th day of April, A. D. 1917.

[SEAL.]

WILLIAM C. COCHRAN,
Clerk of the United States Circuit Court of Appeals for the Sixth Circuit.

177 UNITED STATES OF AMERICA, ss:

The President of the United States of America to the honorable the Judges of the United States Circuit Court of Appeals for the Sixth Circuit, greeting:

Being informed that there is now pending before you a suit in which Emanuel J. Doyle, collector of internal revenue, is plaintiff in error, and Mitchell Brothers Company is defendant in error, No. 2864, which suit was removed into the said Circuit Court of Appeals by virtue of a writ of error to the District Court of the United States for the Western District of Michigan, and we, being willing for certain reasons that the said cause and the record and proceedings therein should be certified by the said Circuit Court of Appeals and
178 removed into the Supreme Court of the United States, do hereby command you that you send without delay to the said Supreme Court, as aforesaid, the record and proceedings in said cause, so that the said Supreme Court may act thereon as of right and according to law ought to be done.

Witness the Honorable Edward D. White, Chief Justice of the United States, the twenty-fourth day of May, in the year of our Lord one thousand nine hundred and seventeen.

[SEAL.] JAMES D. MAHER,
Clerk of the Supreme Court of the United States.

UNITED STATES CIRCUIT COURT OF APPEALS, ss:
For the Sixth Circuit.

I, William C. Cochran, clerk of the United States Circuit Court of Appeals for the Sixth Circuit, do hereby certify that the transcript of the record of the proceedings of this court in the within entitled case heretofore certified by me for filing in the Supreme Court of the United States was correct and complete as the same then appeared in this court.

In pursuance of the command of the foregoing writ of certiorari I now hereby certify that on the 29th day of May, A. D. 1917, there was filed in my office a stipulation in the above entitled case in the following words, to wit:

In the Supreme Court of the United States, October term, 1916.

EMANUEL J. DOYLE, COLLECTOR, ETC., PETITIONER,
v.
MITCHELL BROTHERS COMPANY. | No. 1103.

Stipulation as to return.

It is hereby stipulated by counsel for the parties to the above entitled cause that the certified transcript of the record herein, now on file in the office of the clerk of the Supreme Court, may be taken as the

return of the clerk of the Circuit Court of Appeals for the Sixth Circuit to the writ of certiorari issued herein.

JOHN W. DAVIS, *Solicitor General.*
MARK NORRIS and OSCAR E. WARE,
Counsel for Respondent.

May 25, 1917.
(File No. 174073.)

I further certify that the above is a true and correct copy of said stipulation and of the whole thereof. Witness my official seal, signature, and the seal of said Circuit Court of Appeals at the city of Cincinnati, in said circuit this 29th day of May, A. D. 1917.

[SEAL.] WILLIAM C. COCHRAN,
Clerk United States Circuit Court of Appeals for the Sixth Circuit.

179 (Indorsed:) File No. 25933. Supreme Court of the United States, No. 1103, October term, 1916. Emanuel J. Doyle, collector, etc., vs. Mitchell Brothers Company. Writ of certiorari. Filed May 29, 1917. Wm. C. Cochran, clerk. Office of the clerk, Supreme Court of U. S. Received June 1, 1917.

180 (Indorsed:) File No. 25933. Supreme Court U. S. October term, 1916. Term No. 1103. Emanuel J. Doyle, collector, etc., petitioner, vs. Mitchell Brothers Co. Writ of certiorari and return. Filed June 1, 1917.

( )

In the Supreme Court of the United States.

OCTOBER TERM, 1916.

EMANUEL J. DOYLE, COLLECTOR OF INTERNAL REVENUE, petitioner,
v.
MITCHELL BROTHERS COMPANY. } No.

PETITION FOR A WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF.

The Solicitor General, on behalf of Doyle, collector, prays for a writ of certiorari to review the judgment of the Court of Appeals for the Sixth Circuit in the above-entitled cause.

QUESTION INVOLVED.

Where a company is engaged, under its charter, in manufacturing lumber from its own "stumpage," and selling the same, is that portion of its gross receipts derived from the use of the "stumpage" "gross income" within the meaning of the Corporation Excise Tax Act of August 5, 1909, 36 Stat. 112? If it is, is the company entitled to deduct from these gross receipts the (estimated) value of its "stumpage,"

and especially is such portion of the gross receipts "gross income," or is such a deduction allowable, as to the value of such "stumpage" on January 1, 1909?

STATEMENT OF THE CASE.

The respondent company was formed in 1903 to take over and carry on the business of the Mitchell Brothers, who were timber owners and lumber manufacturers (R. 117, F. VII). The timber lands were turned over to the corporation on an average valuation of $20 an acre, and have always been carried on its books at this valuation (*ib.*). After the Corporation Excise Tax Act went into effect, the vice president of the company revalued its "stumpage" by an estimate as of December 31, 1908, assessing it by the thousand feet, to make it equal to the appreciation accruing from natural causes. This revaluation was not placed on the books (R. 119, F. IX, IX–a), but it was the fair market value of the stumpage on December 31, 1908 (R. 122, F. XIV). In carrying on its business the company, while it kept separate accounts of "stumpage," yet carried it finally into "profit and loss," and either paid dividends therefrom or carried it to "surplus" (R. 119, 120, F. IX–b; R. 128, F. XXX–b, XXX–c). The company for the years 1909, 1910, 1911, and 1912 deducted from its returns under the act the said estimated value of the "stumpage" cut in each of said years as of December 31, 1908. The Commissioner of Internal Revenue in 1913 made an additional assessment upon the company for the

years in question of the difference between what the "stumpage" cost the company estimated at $20 per acre, and its value on December 31, 1908, estimated at $40 per acre (R. 115, F. III; R. 116, F. V). The additional tax was paid and action brought to recover it back. The District Court held that in so far as "stumpage" was concerned there was no income at all, but merely a conversion of capital (225 Fed. 437; Rec. 28–32). The Court of Appeals affirmed the judgment, holding, apparently, that not the services of the capital but the appreciation thereof constituted income; hence the items representing the appreciation of the "stumpage" prior to January 1, 1909, were income prior to that time, and could not be taxed as income thereafter. 235 Fed. 686, 691. A petition for a rehearing was filed and on February 16, 1917, denied, the entire opinion of the court being as follows:

> Per curiam: We have held the application for rehearing in the expectation that the decision of the Supreme Court in *Von Baumbach* v. *Sargent* might affect the reasoning or the conclusions of our opinion in this case. The opinion in that case was announced on January 15, 1917. It does not consider those features of the case that are here involved, and so does not add to the existing knowledge on those subjects.
>
> The merits of the petition have been considered, and we are not convinced that there was any substantial error in the opinion.
>
> The petition is denied.

REASONS FOR THE ALLOWANCE OF THE WRIT.

1. The principles laid down by this court in *Von Baumbach* v. *Sargent Land Company*, 242 U. S. 503, have such a direct bearing on the case at bar as to make it proper to ask this court itself to make the application of them to this case.

2. The case of *Lynch* v. *Hornby*, No. 965 of this term, in which this court granted a certiorari on March 19 last, involved the same question raised in this case, except that the *Hornby* case was one of the liability *under the Income Tax Act of a stockholder on dividends* received from a lumber company which used its own "stumpage." The cases are near enough in principle to justify this court in reviewing the present case also.

3. The principle laid down by this court in *Brushaber* v. *Union Pac. R. R.*, 240 U. S. 1, and *Stanton* v. *Baltic Mining Co.*, 240 U. S. 103, that an income tax is an excise measured by income, irrespective of its source, justifies a request that the opinion of the Court of Appeals in the case at bar, holding that the test is not the income received during the taxing year from capital, but the nature and value of the capital prior to the taxing year, or prior to the time the Act went into effect, should be reviewed by this court.

4. The opinion of the Court of Appeals shows a confusion as to the true legal meaning of "capital" as distinguished from "income" which can not but be exceedingly burdensome to the public and the Government in the execution of the taxing laws bearing upon this important subject.

1. In the *Saryent Land Company* case, 242 U. S. 503, this court, in effect, held that the *proceeds of sale* of ore in a mine received by a corporation in the regular course of its business were income within the meaning of the Corporation Excise Tax Act, and that exhaustion or depletion of capital could not be deducted therefrom as "depreciation." Is not the present case within the rule laid down in that decision? The Court of Appeals, as indicated by its remarks on the petition for a rehearing, quoted above, thought not; presumably for the reason thus stated in its original opinion, 235 Fed. 691, 692:

> Counsel for the collector rely upon a number of cases, mostly English, to support the proposition that where the business which is being carried on contemplates and necessarily involves a wasting of the capital assets, the proceeds of that wasting are entirely income. Of those cases, it is to be noticed that they are mostly mining cases and that mineral out of sight, in the ground, forms a peculiar class of capital assets. It has no market value because it can not be measured, and neither quantity nor quality can be definitely known; it is predominantly speculative, and the difficulty of determining what is capital and what is income is very great, while this standing timber had at all times an easily ascertainable market price. * * *

This court, however, may properly be asked to determine whether its opinion is to be limited in this empirical fashion. No such idea is suggested in the *Sargent Land Company* case. The principle there laid down was that the services performed by capital within the taxing year in question are the "gross income received from all sources" in that year, within the meaning of the act; that the "net income" which is taxable is reached by deducting from this "gross income" those items which the law allows as deductions; that the only allowance possibly covering the case of the intentional conversion of capital into income in a wasting enterprise is "depreciation"; and that depletion of capital can not be included under that head.

In the petition for a writ of certiorari in the *Hornby* case (No. 965) the Government referred to the case of *Kauri Timber Company, Limited*, v. *Commissioners of Taxes* (1913), A. C. 771. The following language of the Privy Council in that case is here repeated:

> *The law*—so clearly settled with regard to the working of coal and nitrates, and *settled upon a broad general principle—is in no way different when it comes to be applied to timber-bearing lands.* [Italics mine.]

Looked at broadly, the position of the respondent, as affirmed by the Court of Appeals, has a certain want of broad equity. One of the greatest evils to this country is the wholesale destruction of its timber. The cutting of it for immediate profit without

any attempt to replace it by planting constitutes, in various ways, a danger to the public. This destruction, however, is now claimed as an advantage in that though great profits are admittedly derived from it they are not taxable as income for the very reason that they represent this wasteful conversion of capital assets.

More than this, the Court of Appeals evidently thinks that the *annual appreciation* of timber lands should be taxed as income. Apart from the manifest impossibility of an annual computation by the Federal Government of the value of all the timber lands in the United States, such a tax would fall upon the very person who should not pay it, namely, the person who is endeavoring to develop his trees as a steady income bearing proposition.

2. Upon this point the court is referred to the petition of a writ of certiorari in the *Hornby* case, No. 965 this term, and especially to point 2 in the brief in support of the petition.

3. This court in the so-called *Income Tax Cases* (*Brushaber, &c.*), *supra*, clearly decided that the Sixteenth Amendment had not created a new kind of direct tax not subject to apportionment, but had left the tax what it was before, an excise, simply prohibiting an inquiry into the nature of the capital from which the income had been derived in order to determine the validity of the tax.

It is true this decision only applied to an income tax after the passage of the Sixteenth Amendment.

It would seem, however, that an excise on the privilege of doing business as a corporation, and measured by income, would be subject to the same rule prior to the passage of the amendment as a direct income tax after such passage, namely, that the nature of the capital from which the income is derived, or the time when such capital was accumulated is immaterial. Clearly there would have been very little revenue derived from the Corporation Excise Tax in 1909 if all income derived from capital accumulated prior to that year was to be excluded. To make the test the nature and value of the capital assets on December 31, 1908, is to read provisions into the act irreconcilable with its terms, and entirely to change the system of taxation provided thereby.

4. The confusion as to the legal meaning of "capital" and "income" shown in the opinion of the Court of Appeals can not be illustrated by an excerpt, but can only be observed by a careful reading of the whole opinion. Certain examples thereof may, however, be given. The Court of Appeals says, 235 Fed. 687:

> * * * The decisive question here is whether the $20 difference—*the additional value* of the timber which had accrued before 1909, but had not been entered on the books—*was* taxable *income* for 1909. [Italics mine.]

"The additional value" of property, however, can never constitute its "income." Such value may never be realized. This timber might have been burnt immediately after December 31, 1908. It is only when the timber is sold or in other ways produces service to its owner that income arises.

The court states further, 235 Fed. 687:

> It is clear that, by the term "income," Congress did not intend to include the proceeds of capital assets sold or converted during the year.

But the "income" of every merchant consists of the proceeds of capital assets sold during the year, so that the court's statement is manifestly incorrect.

Finally, the court adopts the following definition of "income," 235 Fed. 691:

> * * * (3) we may say that the appreciation therein ["capital assets"] and gain thereupon during the period and found at its end in realizable form is income.

That is, the income from a rented house is not the rental, but the difference in the value of the house between the first and the end of the year. Under such a theory there would be no necessity for any special provision in the act for deducting "depreciation," since "depreciation" would necessarily enter into the valuation of the house. In fact, the above definition clearly makes the tax one on property or capital, and not on income. It substitutes a system of valuation of assets, in place of the simple system

provided for by the act of computing the income actually received from all sources and making therefrom specific, statutory deductions.

CONCLUSION.

It is submitted that the writ should issue as prayed.

JOHN W. DAVIS,
Solicitor General.

APRIL, 1917.

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In the Supreme Court of the United States.

OCTOBER TERM, 1917.

EMANUEL J. DOYLE, COLLECTOR OF INTERNAL REVENUE, petitioner.
v.
MITCHELL BROTHERS COMPANY.
No. 492.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

MOTION BY THE UNITED STATES TO ADVANCE.

Comes now the Solicitor General, appearing on behalf of petitioner, and respectfully moves the court to advance the above-entitled cause for hearing on a day convenient to the court.

This is a suit to recover taxes paid under protest on the ground that the taxes were erroneously assessed and collected within the meaning of the Corporation Excise Tax Act of August 5, 1909, 36 Stat. 11, 112.

The question presented is:

> Where a company is engaged, under its charter, in manufacturing lumber from its own "stumpage," and selling the same, is that portion of its gross receipts derived from the use of the "stumpage" "gross income" within

the meaning of the Corporation Excise Tax Act of August 5, 1909, 36 Stat. 112? If it is, is the company entitled to deduct from these receipts the (estimated) value of its "stumpage," and especially is such portion of the gross receipts "gross income," or is such a deduction allowable, as to the value of such "stumpage" on January 1, 1909?

The case is of importance to the public revenues, and the decision will determine the disposition of many similar cases now pending.

If the case be advanced, it is requested that it be set down for hearing on the same date as Nos. 421 and 422, which involve a similar principle with reference to the construction of the Income Tax Act of October 3, 1913.

Notice of this motion has been served on opposing counsel.

JOHN W. DAVIS,
Solicitor General.

OCTOBER, 1917.

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UNITED STATES OF AMERICA.

THE SUPREME COURT OF THE UNITED STATES

EMANUEL J. DOYLE, Collector of Internal Revenue, *Petitioner,*
vs.
MITCHELL BROTHERS CO., *Respondent.*

No. 492.
October Term, 1917.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Sixth Circuit.

BRIEF FOR RESPONDENT MITCHELL BROTHERS COMPANY.

MARK NORRIS,
OSCAR E. WAER,
Of Counsel for Respondent
Mitchell Brothers Co.

INDEX.

	Pages
Table of Cases Cited	b–i
Propositions of Law with Citations	j–o
Statement of Facts and Issues	1–9
Contentions of Respondent	9

ARGUMENT.

I. The timber stumpage valued as of December 31, 1908, was not part of the gross amount of the income received,

First: Because it was not income at all, either gross or net, but was capital 10–57

Second: Even if part of the gross amount of the income, it was not received within the year 57–59

II. Even if the amount received for the stumpage could all be considered income, the value which the stumpage had on January 1, 1909, was part of the manufacturing cost of the lumber and deductible as such 59–63

III. When the Government exacts a tax from the citizen, it must bring itself clearly within the law 63–68

IV. The value of the company's timber on December 31, 1908, is a question of fact to be determined from evidence, and not from arbitrary figures used in the company's bookkeeping 68–61

V. Minor Items involved in case:

A. Stump Lands 81–82

B. Word Stumpage 82–83

C. Square Timber and Cedar Products 83

D. Real Estate 83–84

APPENDIX.

Resume of Treasury Decisions 35–101

PAGES

TABLE OF CASES CITED

Adams, Owens v. Fed. Cas. No. 10633 — 79

American Net & Twine Co. v. Worthington, 141 U. S. 468, 474 — 65

American Surety Co. v. Pauley, 72 Fed. 470 — 79

Anderson v. Broadway, 239 U. S. 69 — 11

Appeal of Earp, 28 Pa. 368, 375 — 42

Appeal of Wiltbank, 64 Pa. 256, 259 — 42

Armitage v. Garnett, 3 Ch. Div. (1893) 337, 347 — 41

Assets Co. v. Inland Revenue, 24 Sessions Cas. 5 — 70, 77

Atlantic Trust Co., Darlington v., 68 Fed. 849 — 79

Auditor General, Chicago, etc., R. R. Co. v., 53 Mich. 79, 85, 86 — 80

Bailey v. R. R. Co., 106 U. S. 109 — 34, 37, 70, 73

Baldwin Loco. Works v. McCoach, 215 Fed. 967 (Affirmed C. C. A. 3rd Circuit, 221 Fed. 60) — 70, 72

Baltic Mining Co., Stanton v., 240 U. S. 103 — 48, 50

Bank v. Jones, 21 Wall. 325 — 79

Bank, Nelson v., 69 Fed. 798 — 79

Bank v. Rawls, 7 Ga. 191 — 79

Barber v. Bull, 7 Watts & S. 791 — 79

Barker, People v., 39 N. Y. Supp. 776 — 78

Bartlett, Gill v., 224 Fed. 927, 928 — 64

Benziger v. United States, 192 U. S. 38, 55 — 65

Bishop, Gresham Life Ins. Co. v., 71 L. J. K. B., 618 — 70, 76

Biwabic Mining Co. v. United States, 242 Fed. 9 — 12, 20, 25

Black, Coltness Iron Co., v., (1881), 6 App. Cas. 315 — 56

Britton, Mills v., 64 Conn. 4, 29 Atl. 231, 236 — 41, 45

Broadway, Anderson v., 239 U. S. 69 — 11

Brown v. French, 80 Fed. 166 — 80

Brown v. United States, 113 U. S. 571 — 18

	Pages
Buchanan, Mercer v., 13 Fed. 501, 507	41
Building & Loan Assn. v. Herold, 203 Fed. 876	67
Bull, Barber v., 7 Watts & S. 391	79
C. B. & Q. R. R. Co. v. Page, Fed. Cas. No. 2668 (1 Biss. 461)	34, 39
Carr, Vanatta v., 229 Ill. 47	42
C. C. C. Ry. Co. v. United States, 242 Fed. 18	20, 28
Central R. R. v. State Board, 49 N. J. L. 1	78
Century Dictionary Encyclopedia (1911)	42
Chicago, Etc., R. R. v. Auditor General, 53 Mich. 79, 85, 86	71
The Colon, Fed. Cas. No. 3025	79
Coltness Iron Co. v. Black (1881) 6 App. Cas. 315,	56
Commercial Bank v. Sanford, 103 Fed. 98, 100	65
Commissioner of Texas, Kauri Timber Co. v., (1913) App. Cas. 771	56
Cooke, Gibson, v., 1 Metc. 75	42
Crookston Bros. v. Inland Revenue, Sessions Cas. (1911) 217	70, 77
Cross v. Trust Co., 75 H[illegible]. 533	42
37 Cyc. 1011	78
Dallas, Little Granite Rock v., 66 Fed. 522	79
Darlington v. Atlantic Trust Co., 68 Fed. 849	79
Darlington, Gray v., 82 U. S. (15 Wall.) 63	34, 79
Davenport, People v., 30 Hun. 177, 184	40
Dunnell Mfg. Co. v. Pawtucket, 7 Gray 277	80
Early v. Friend, 16 Gratt (Va.) 21	58
Eidman v. Martinez, 184 U. S. 578	65
Equitable Trust Co. v. Gelden, Fed. Cas. No. 5408 (Affirmed 94 U. S. 419)	65
Fall River, Troy v., 167 Mass. 517	80
Fanche, Schell v., 138 U. S. 572	18
Field, Remington v., 16 R. I. 509	42
Fish Co., United States v., 146 Fed. 104, 106	65
Fiske, Smythe v., 23 Wall. 374, 382	18

PAGES

Flint v. Stone Tracy Co., 220 U. S. 107 11
Forbes v. Scottish Provident Assn., 33 Scottish Law Rep. 228 ..... 70, 77
Forty Fort Coal Co. v. Kirkendall, 233 Fed. 704 ..... 20, 31, 70
French, Brown v., 80 Fed. 166 80
Friend, Early v., 16 Gratt. (Va.) 21 58
Funk & Wagnalls New Standard Dictionary (1913) 42
Garnett, Armitage v., 3 Ch. Div. (1893) 337, 347 41
Gauley Mountain Coal Co. v. Hayes, 230 Fed. 110 ..... 20, 23
Gibbons v. Mahon, 136 U. S. 549 41
Gibson v. Cooke, 1 Metc. 75 42
Gilford, Winnipeseogo Lage v., 67 N. H. 514 78
Gill v. Bartlett, 224 Fed. 927, 928 64
Gould v. Gould (Nov. 19, 1917) 65
Graham's Est., 198 Pa. St. 216 42
Gray v. Darlington, 82 U. S. (15 Wall.) 63 ..... 34, 79
Gulf Oil Co. v. Lewelyn, 242 Fed. 709 ..... 20, 32
Gresham Life Inc. Co. v. Biship, 71 L. J. K. B. 618 ..... 70, 76
Guggenheim, United States v., 238 Fed. 213 ..... 20, 32
Hahn v. United States, 107 U. S. 406 18
Hampton v. Michael, 6 Gratt. 151 79
Hartrauft v. Wiegmann, 121 U. S. 609, 616 65
Harvey v. United States, 113 U. S. 243 79
Hayes & Co. v. United States, 150 Fed. 63, 66 65
Hayes, Gauley Mountain Coal Co. v., 230 Fed. 110 ..... 20, 23
Hempsted v. Thomas, 122 Fed. 539 65
Herold, Building & Loan Assn. v., 203 Fed. 876 67
Herold, Mutual Benefit v., 198 Fed. 199 (Judgment Affirmed: 201 Fed. 918) 67
Hill, United States v., 120 U. S. 182 18
Hooper, Smith v., 95 Md. 27 ..... 42, 45
Howbert, Strattons Independence v., 231 U. S. 399, 414 11

	Pages
Industrial Trust Co. v. Walsh, 222 Fed. 437	20, 21, 70, 73
Inland Revenue, Assets Co. v., 24 Sessions Cas. 5	70, 77
Inland Revenue, Crookston Bros. v., Sessions Cas. (1911) 217	70, 77
Iowa v. McFarland, 110 U. S. 471, 485	18
Isham, United States v., 17 Wall. 504	42, 65
Jones, Bank v., 21 Wall. 325	79
The Kate Irving, 5 Fed. 630	79
Kauri Timber Co. v. Commissioner of Taxes (1913) App. Cas. 771	56
Kirby, United States v., 7 Wall. 482, 486	63
Knowlton v. Moore, 178 U. S. 41, 77	63
Leather National Bank v. Treat, 128 Fed. 262, 62 C. C. A. 644	70, 76
Lynch v. Turrish, 236 Fed. 653	20, 30
Little Granite Rock v. Dallas, 66 Fed. 522	79
Lynch v. Hornby, 236 Fed. 653	20, 31
McCartney, Merchants Fire Ins. Co. v., Fed. Cas. No. 9443 (1 Lowell 447)	34
McClain, Penn. Co. v., 105 Fed. 367, 370	65
McCoach, Baldwin Loco. Works v., 215 Fed. 967 (Affirmed C. C. A. 3rd Circuit, 221 Fed. 60)	70, 72
McCoach v. Minehill, 228 U. S. 295, 306	11
McFarland, Iowa v., 110 U. S. 471, 485	18
Mahon, Gibbons v., 136 U. S. 549	41
Marquette, Etc., R. R. Co. v. United States, 123 U. S. 722	70, 75
Marshall, Thompson, v., 73 Conn. 89	58
Martinez, Eidman v., 184 U. S. 578	65
Mathewson v. United States, 71 Fed. 394, 395	65
Mercer v. Buchanan, 32 Fed. 501, 507	41
Merchants Fire Ins. Co. v. McCartney, Fed. Cas. No. 9443 (1 Lowell 447)	34, 38
Merck, United States v., 91 Fed. 639, 640	65
Michael, Hampton v., 6 Gratt. 151	79

Pages

Miholovitch, Voight v., 125 Fed. 78, 83 65
Miller v. Payne, 150 Wis. 354, 378 41
Mills v. Britton, 64 Conn. 4, 29 Alt. 231, 36 ..... 41, 45
Minehill, McCoach v., 228 U. S. 295, 306 11
Mitchell v. Insurance Co., 92 Mich. 594 60
Moore, Knowlton v., 178 U. S. 41, 77 63
Mutual Benefit v. Herold, 198 Fed. 199 (Judgment Affirmed: 201 Fed. 918) 67
Nelson v. Bank, 69 Fed. 798 79
Nipissing Mines Co., United States v., 202 Fed. 803 (Modified and affirmed on other grounds, 206 Fed. 431) 70, 73, 79
The Norma, 68 Fed. 509 79
North Carolina Corp. Comm., Southern R. R. v., 97 Fed. 513, 518 65
Oliver's Estate, 136 Pa. St. 43 42
Owens v. Adams, Fed. Cas. No. 10633 79
Page, C. B. & Q. R. R. Co. v., Fed. Cas. No. 2668 (1 Biss. 461) 34, 39
Park's Estate, 173 Pa. St. 190 42
Pauley, American Surety Co. v., 72 Fed. 470 79
Pawtucket, Dunnell Mfg. Co. v., 7 Gray 277 80
Payne, Miller v., 150 Wis. 354, 378 41
Peabody v. Stark, 16 Wall. 240 18
People v. Barker, 39 N. Y. Supp. 776 78
People v. Davenport, 30 Hun. 177, 184 40
People, Walker v., 192 Ill. 106 78
Penn. Co. v. McClain, 105 Fed. 367, 370 65
Pa. Steel Co. v. Railway Co. (C. C. A. 2nd Circuit) 198 Fed. 774, 775 67
Phillips, Spooner v., 62 Conn. 62 ..... 42, 45
Pollock v. Farmers Loan & Trust Co., 157 U. S. 595 63
R. R. Co., Bailey v., 106 U. S. 109 ..... 34, 37, 70, 73
R. R. Co. v. Hooker, 233 U. S. 97, 118 18

	Pages
Railroad Co. v. United States, 110 U. S. 205, 208	70, 76
Railway Co., Pa. Steel Co. v., (C. C. A. 2nd Circuit) 98 Fed. 774, 775	67
Rawls, Bank v., 7 Ga. 191	79
Remington v. Field, 16 R. I. 509	42
Reynolds v. Williams, Fed. Cas. No. 11734. (4 Biss. 108)	34, 40
Ricaud, State vs., 90 Fed. 214	80
Rice v. United States, 53 Fed. 910, 912	65
Sanford, Commercial Bank v., 103 Fed. 98, 100	65
Sargent Land Co. v. Von Baumbach, 242 U. S. 48	70
Schell v. Fanche, 138 U. S. 572	18
Scottish Provident Insurance, 1912 Session Cases 452 (Scotch)	58
Scottish Provident Assn., Forbes v., 33 Scottish Law Rep. 228	70, 77
Selden, Equitable Trust Co. v., Fed. Cas. No. 5408 (Affirmed 94 U. S. 419)	65
Seligman on the Income Tax (1911)	42, 44, 45
Shallus v. United States, 162 Fed. 653, 656	65
Smith v. Hooper, 95 Md. 27	42, 45
Smythe v. Fiske, 23 Wlal. 374, 382	18
In re Southern Pacific R. R. Co., 82 Fed. 639, 640	65
Southern Pacific v. Lowe, 238 Fed. 847	21, 32
Southern R. R. v. North Carolina Corp. Comm., 97 Fed. 513, 518	65
Spooner v. Phillips, 62 Conn. 6	42, 45
Spreckles Sugar Co. v. McClain, 192 U. S. 397	15
Stark, Peabody v., 16 Wall. 240	18
Stanton v. Baltic Mining Co., 240 U. S. 103	48, 50
State v. Ricaud, 90 Fed. 214	80
State Board, Central R. R. v., 49 N. J. L. 1	78
Stone Tracy Co., Flint v., 220 U. S. 107	11
Strattons Independence v. Howbert, 231 U. S. 399, 414	11, 48

	Pages
Swan Finch Co. v. United States, 190 U. S. 143, 146	65
Thomas, Hempstead v., 122 Fed. 539	65
Thompson v. Marshall, 73 Conn. 89	38
Toune v. Eisner (Jan. 7, 1918)	20, 28
Treasury Decisions 1571, 1588, 1060, 1675, 1706, 1727, 1742, 1754, 1755, 1833, 2130	17, 85–101
Treat, Leather National Bk. v., 128 Fed. 262, 62 C. C. A. 644	70
Troy v. Fall River, 167 Mass. 517	80
Trust Co., Cross v., 75 Hun. 533	42
United States, Benziger v., 192 U. S. 38, 55	65
United States v. Brown, 159 U. S. 78	59
United States, Brown v., 113 U. S. 571	18
United States v. Fish Co., 146 Fed. 104, 106	65
United States v. Guggenheim, 238 Fed. 231, 236	70
United States, Hahn v., 107 U. S. 406	18
United States, Harvey v., 113 U. S. 243	79
United States, Hayes & Co. v., 150 Fed. 63	65
United States v. Hill, 120 U. S. 182	18
United States v. Isham, 17 Wall. 504	42, 65
United States v. Kirby, 7 Wall. 482, 486	63
United States, Marquette, Etc., R. R. Co. v., 123 U. S. 722	70, 75
United States, Mathewson v., 71 Fed. 394, 395	65, 70
United States v. Merck, 91 Fed. 639, 640	65
United States v. Nipissing Mines Co., 202 Fed. 803 (Modified and affirmed on other grounds, 206 Fed. 431)	70, 73, 79
United States, Railroad Co. v., 110 U. S. 205, 208	70, 76
United States v. Railroad Co., 17 Fed. 719	75
United States v. Railroad Co., 142 U. S. 615	18
United States, Rice v., 53 Fed. 910, 912	65
United States, Shallus v., 162 Fed. 653, 656	65

Pages

United States, Swan Finch Co. v., 190 U. S. 143, 146 ____ 65
United States v. Whitridge, 231 U. S. 144, 147 ____ 11
Vanatta v. Carr, 229 Ill. 47 ____ 42
Voigt v. Milholovitch, 125 Fed. 78, 83 ____ 65
Von Baumbach, Sargent Land Co. v., 242 U. S. 503 ____ 48, 70
Walker v. People, 192 Ill. 106 ____ 78
Walsh, Industrial Trust Co. v., 222 Fed. 437 ____ 20, 21, 70
West v. Weyer, 46 Ohio St. 66 ____ 58
In re Wetherell, 60 Fed. 267, 270 ____ 65
Weyer, West v., 46 Ohio St. 66 ____ 58
Whitridge, United States v., 231 U. S. 44, 147 ____ 11
Wiegmann, Hartrauft v., 121 U. S. 609, 616 ____ 65
3 Wigmore on Evidence, 1943 ____ 79
Williams, Reynolds v., Fed. Cas. No. 11734 (4 Biss. 108) ____ 34
Winnipeseogo Lake v. Gilford, 67 N. H. 514 ____ 78
Worthington, American Net & Twine Co. v., 141 U. S. 468, 474 ____ 65

Pages

PROPOSITIONS OF LAW WITH CITATIONS.

(1) The Act of Aug. 5, 1909, imposes an excise tax, the tax being measured by the amount of the income 11

Anderson v. Broadway, 239 U. S. 69.
Flint v. Stone Tracy Co., 220 U. S. 107.
McCoach v. Minehill, etc., R. R. Co., 228 U. S. 295.
United States v. Whiteridge 231 U. S. 144,
Strattons Ind. v. Howbert, 231 U. S. 399,

(2) The timber stumpage valued as of Dec. 31, 1908, was capital, and was not income at all, gross or net, within the meaning of the law 10–57

Treasury Decisions No. 1571, 1588, 1606, 1675, 1706, 1727, 1742, 1754 1755, 1833, 2130.
Industrial Trust Co. v. Walsh 222 Fed. 437.
Gauley Coal Co. v. Hayes 230 Fed. 110.
Biwabic Mining Co. v. United States, 242 Fed. 9.
C. C. C. Ry. Co. v. United States, 242 Fed. 18.
Forty Fort Coal Co. v. Kirkendall, 233 Fed. 704.
United States v. Guggenheim, 238 Fed. 231.
Towne v. Eisner (Jan. 7, 1918, U. S. Adv. Op.)
Lynch v. Hornby, 236 Fed. 661.
Lynch v. Turrish, 236 Fed. 653.
Gulf Ore Co. v. Lewellyn, 242 Fed. 709.
So. Pacific v. Lorve, 238 Fed. 847.
Gray v. Darlington, 82 U. S. (15 Wall. 63)
Bailey v. R. R. Co., 106 U. S. 109.
Merchants Fire Ins. Co. v. McCartney, Fed. Cas. No. 9443 (1 Lowell 447).
C. B. & Q. R. R. Co. v. Page, Fed. Cas. No. 2668, (1 Biss. 461).
Reynolds v. Williams, Fed. Cas. No. 11734, (4 Biss. 108).
People v. Davenport, 30 Hun. 77, 184.

Pages

Spreckles Sugar Co. v. McClain, 92 U. S. 397.
Mercer v. Buchanan, 132, Fed. 501, 507.
Gibbons v. Mahon, 136 U. S. 549.
Armitage v. Garnett, 3 Ch. Div. (1893) 337, 347.
Mills v. Britton, 64 Conn. 4, 29 Atl. 231, 236.
Miller v. Payne, 150 Wis. 354, 378.
Gibson v. Cooke, 1 Metc. 75.
Cross v. Trust Co., 75 Hun. 533.
Smith v. Hooper, 95 Md. 27.
Appeal of Earp, 28 Pa. 368, 375.
Appeal of Wiltbank, 64 Pa. 256, 259.
Graham's Est. 198 Pa. St. 216.
Oliver's Estate, 136 Pa. St. 43.
Vanatta v. Carr, 229 Ill. 47.
Parks' Est., 173 Pa. St. 190.
Remington v. Filed, 16 R. I. 509.
Spooner v. Phillips, 62 Conn. 62.
Funk & Wagnalls New Standard Dictionary (1913).
Century Dictionary Encyclopedia (1911).
Seligman on the Income Tax (1911).

(3) The long continued construction of a statute by the Department charged with its execution should not be overruled except for cogent reasons 18

United States v. Military Constr. Co., 204 Fed. 153.
Schell v. Fanche, 138 U. S. 572.
Brown v. United States, 113 U. S. 571.
Iowa v. McFarland, 110 U. S. 471, 485.
Smythe v. Fiske, 23 Wall. 374, 382.
United States v. Hill, 120 U. S. 182.
Peabody v. Stark, 16 Wall. 240.
Hahn v. United States, 107 U. S. 406.

(4) The Mining cases discussed 48–50

Stratton's Independence v. Howbert, 231 U. S. 399.
Stanton v. Baltic Mining Co., 240 U. S. 103.
Von Baumbach v. Sargent Land Co., 242 U. S. 503.

Pages

(5) The English cases discussed 56–57

Coltness Iron Co. v. Black, 6 App. Cas. 315 (1881).
Kauri Timber Co. v. Comm. of Taxes, (1903) App. Cas. 771.

(6) Even if the timber stumpage valued as of Dec. 31, 1908, could be considered as part of gross amount of the income, it was not received within the taxing years 57–59

Gray v. Darlington, 82 U. S. (15 Wall.) 63.
Reynolds v. Williams, Fed. Cas. No. 11734.
Early v. Friend, 6 Gratt. (Va.) 21.
West v. Weyer, 46 Ohio St. 66.
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United States v. Am. Sugar Co., 202 U. S. 577.
United States v. Brown, 159 U. S. 78, 82.

(7) Even if the amount received for the stumpage could all be considered income, the value which the stumpage had on Jan. 1, 1909, was part of the manufacturing cost and deductible as such 59–63

Mitchell v. Insurance Co., 92 Mich. 594.

(8) Courts should avoid a construction which will make a law operate with glaring inequality and with palpable injustice 63

Knowlton v. Moore, 178 U. S. 41, 77, and numerous cases therein cited.
United States v. Kirby, 7 Wall. 482, 486.

(9) When the government exacts a tax from the citizen, it must bring itself clearly within the law. 63–68

Pollock v. Farmers Loan & Trust Co., 157 U. S. 595.

Pages

Spreckles Sugar Co. v. McClain, 192 U. S. 397, 416.
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United States v. Fish Co., 146 Fed. 104, 106.
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Mathewson v. United States, 71 Fed. 394, 395.
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Penn Co. v. McClain, 105 Fed. 367, 370
U. S. v. Isham, 17 Wall. 504.

(10) And the Corporation Excise Tax Law comes within the same rule. It must be strictly construed and all reasonable doubts in respect thereto should be resolved against the government and in favor of the citizen..... 67

Pa. Steel Co. v. Railway Co., (C. C. A. 2nd Circuit) 198 Fed. 774, 775.
Mutual Benefit v. Herold, 198 Fed. 199.

Pages

(Judgment affirmed: 201 Fed. 918.)
Building & Loan Assn. v. Herold, 203 Fed. 876.

(11) The value of the Company's stumpage on Dec. 31, 1908, is a question of fact to be determined from evidence ,and not from arbitrary figures used in the company's bookkeeping..... 68–81

Baldwin Loco. Works v. McCoach, 215 Fed. 967. (Affirmed C. C. A. 3rd Circuit, 221 Fed. 60.)
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UNITED STATES OF AMERICA.

THE SUPREME COURT OF THE UNITED STATES

EMANUEL J. DOYLE, Collector of Internal Revenue, *Petitioner,*
vs.
MITCHELL BROTHERS CO., *Respondent.*

No. 492.
October Term, 1917.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Sixth Circuit.

At the time of sending this brief to the printer, we have not received the brief of the Solicitor General though the time for filing and serving same has gone by, and therefore find it necessary to make a statement of the facts involved and the questions presented.

I.

The Solicitor General, in his application for the Writ of Certiorari, has misconceived the question involved in this case, which, concretely illustrated, is:

What is the income of a lumber manufacturing concern which owns timber on December 31, 1908

(the day before the Corporation Excise Tax Law of August 5, 1909, became operative), the market value of which at that time, as found by the Court, was $50,000; which manufactures and sells such lumber during the year 1909 for $100,000, less expenses of manufacture and sale amounting to $25,000; and which has on hand at the end of the year $75,000 in cash and no timber? Is its income (the measure of its tax under the law) $25,000 or $75,000?

II.

THE FACTS IN THE CASE.

Mitchell Brothers Company, a corporation which was subject to the excise tax imposed under Act of August 5, 1909, was and is engaged in the manufacture and sale of lumber. The company manufactures its lumber and other products from its own timber lands which it purchased prior to January 1, 1909, when the excise tax law became operative (R. 99; Finding No. VII). Most of the timber lands were purchased many years ago by W. W. Mitchell and A. W. Mitchell, who carried on the business as co-partners until 1903, when the present corporation was organized (R. 99). Some time prior to the reorganization, the partners revalued their timber lands, placing various prices on various descriptions, which prices approximated an average valuation of $20.00 per acre. The lands were turned over to the corporation on this basis, and were entered and remained on its books at the same valuation. There was a large increase in value from 1903 to 1909, but the appreciation in value was never carried into the books. Not even taxes and carrying charges were added to the original book value, the same being annually absorbed in the company's expense account (R. 99, Finding No. VII).

At about the time of its organization, the company adopted, in its bookkeeping, the following method of keeping its timber land account: At the end of each year,

there was transferred from the timber land account into the lumber account, the timber which had been cut and manufactured into lumber during the year, and there was transferred into a stump land account the lands which had been cut over during the year. This transfer was made by crediting the timber land account with all hardwood and hemlock timber cut at the rate of $2.25 per thousand, with all pine timber cut at the rate of $8.00 per thousand, and with all lands cut over at the rate of $2.00 per acre; and by making a corresponding charge of the same items to the timber and stump land accounts respectively (R. 99, Finding VIII). It was estimated at that time that, by using these figures of $2.25 and $8.00 per thousand for stumpage, and $2.00 per acre for stump lands, the timber land account would just about be wiped out when all the timber was removed. On account of closer cutting in later years, and on account of improved methods and utilization of by-products originally regarded as worthless, this proved untrue, but the company, nevertheless, continued to use the same figures in its bookkeeping down to the present time (R. 99, 100, Finding VIII). These figures, however, have not been considered as in any way indicative of the actual market value of the company's timber during recent years, and the figures have been used for purposes of bookkeeping only (R. 61, 62).

Each year the company entered on its books as a profit the difference between the original cost and the sums received for the manufactured product cut from an acre, less the cost of manufacturing, and the profits so entered were further paid out in dividends or carried into the surplus account. Owing to the large overcut and the method of bookkeeping used by the company, there was in each of the years in question a difference between the book profit and the net income shown by the returns made under the Act of August 5, 1909.

After the passage of the Corporation Excise Tax Law of August 5, 1909, and preparatory to making its returns of income under the law, the officers of the company determined what was the fair market value on December 31, 1908, the day before the law became operative, of the timber stumpage owned by the company on that date. Valuations per thousand, log scale, were placed on the different kinds of timber on the basis of what the stumpage would have sold for in open market on December 31, 1908 (R. 100, Finding IX). These valuations, made upon the basis of price per thousand, were never entered in the corporate books and never affected the showing of profits made thereon. The District Court found that the valuations thus fixed were not excessive, and that the fair market value of the timber stumpage of the company on December 31, 1908, was actually equal to such valuations (R. 104, Finding XIV). Counsel for the Government did not question this finding nor the good faith and accuracy of the company in making these valuations.

In compliance with the provisions of the Corporation Excise Tax Law, the company made a return in each of the years 1909, 1910, 1911 and 1912 (R. 97). In computing its taxable income in each of such returns, the company deducted from its gross receipts the actual market value on December 31, 1908, of the timber stumpage cut and converted during the year covered by the tax, on the theory that, at the date of the first incidence of the tax, the property it then had, at its then fair market value, constituted its capital assets, wholly independent of what it had paid for such assets years before. This value was arrived at by taking the total number of feet, log scale, of the various kinds of timber cut during the year and applying thereto the value per thousand which had been fixed as of December 31, 1908. The District Court found that the amount deducted for the various years for timber

stumpage cut and converted was actually the market value of such timber stumpage on December 31, 1908 (R. 104, Finding XIV). This finding was not questioned by the Government, as was none of the other findings of fact.

This absorption of the value on January 1, 1909, of the stumpage did not operate to wipe out all of the taxable income of Mitchell Brothers Company. The company accounted to the Government for all the profit derived from the manufacture and sale of its timber, and it also accounted to the Government for all the increase in value which accrued after December 31, 1908. Thus for the year 1909, it paid an excise tax on a net income of $26,302.34, or about $1.25 per thousand feet; for 1910, $55,292.16, or about $2.40 per thousand feet; for 1911, $56,219.27, and for 1912, $77,134.84, or about $3.00 per thousand feet (R. 76-93).

An assessment was duly made by the Commissioner of Internal Revenue upon each of the returns for the years mentioned, and the excise taxes so levied were paid by the company. Later on, the Commissioner made an additional assessment for each of the four years. This assessment, insofar as the timber stumpage is concerned, was based upon the difference between the actual market value of the stumpage on December 31, 1908, and the value of such stumpage as determined by the book entries of $2.25 per thousand for hardwood and hemlock, and $8.00 per thousand for pine. That is, instead of permitting the company to deduct the actual market value of the stumpage on December 31, 1908, the Government permitted it to deduct only the value as used in these book entries.

The following table shows the amount of income returned by the company, and the amount which the Government, in making the reassessment, claims should have been returned:

Year	Amt. Iucome Returned	Amt. Income on which Reassessment made
1909	$26,302.34	$ 94,811.43
1910	55,292.16	110,655.47
1911	61,219.27	100,417.91
1912	82,134.84	192,266.19
Total	$224,948.61	$498,151.00

Amount added $273,202.39

Additional tax $2,732.02

The difference upon which the Government based its reassessment is shown in detail by the following table:

Property sold or converted by years	Actual value (on Dec. 31, 1908) of stumpage, etc., converted. This amt. deducted as capital in company's return	Book value (stumpage on basis of $2.25 and $8 per M.). This amt. conceded by Gov't to be properly deductible as capital	Difference claimed by Gov't to be Income	Tax in dispute, assessed and paid under protest	
1909					
Stumpage	$109,927.04	$ 54,048.06	$ 55,878.98	$ 558.79	
Other property	12,630.11	none	12,630.11	126.30	
1910					
Stumpage	104,038.33	58,038.28	46,000.05	460.00	
Other property	13,363.26	4,000.00	9,363.26	93.63	
1911					
Stumpage	83,903.56	51,979.39	31,924.17	319.24	
Other property	7,274.47	none	7,274.47	72.75	
1912					
Stumpage	122,097.23	48,517.92	73,579.31	735.79	
Other property	36,552.04	none	36,552.04	365.52	
Totals	$489,786.04	$216,583.65	$273,202.39	$2,732.02	Total additional tax.

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The additional excise taxes so levied were paid by the company under duress (R. 32) and protest (R. 97), and after all necessary preliminary proceedings were taken, this suit was brought to recover the amounts so paid (R. 97, 98). Besides the amount deducted by the company for timber stumpage cut and converted during the taxing years, there are involved in this suit other and minor items which will be hereinafter separately treated.

The District Court held that the timber lands of Mitchell Brothers Company were capital assets on January 1, 1909, when the excise tax law became effective, at their then fair market value; and that the company's taxable income was represented by its gross receipts less operating expenses and less the fair market value on January 1, 1909, of the stumpage consumed (R. 24).

The District Court did not hold, as stated in the petition of the Solicitor General applying for the Writ of Certiorari, that "insofar as stumpage was concerned, there was no income at all, but merely a conversion of capital". Mitchell Brothers Company had paid the excise tax on all of the profits or income derived *from* the *manufacture* and *sale* of its stumpage, and it had also accounted to the Government for and paid the excise tax on all of the *increase in value which accrued after December 31, 1908* (R. 76-93).

The Circuit Court of Appeals affirmed the judgment of the District Court (R. 129), and later denied a motion for rehearing (R. 139).

Insofar as the timber stumpage items are concerned, the additional assessments against the company were imposed by the United States on the theory:

First: That the company must return as net income the proceeds derived from the manufacture and sale of its timber products after deducting *only the original cost of the timber lands;* and

Second: That even if the company could be allowed to deduct as and for restoration of capital assets, the value of its stimpage on December 31, 1908, then that value must be conclusively presumed to have been $2.25 per thousand for hardwood and hemlock stumpage, and $8.00 per thousand for pine stumpage, those being the figures used by the company in its book entries.

On the trials below the Government abandoned both of these theories, upon which the additional assessment was based, and claimed:

That the company must return as net income the proceeds derived from the manufacture and sale of its timber products, without deducting anything for either the *value* or the *cost* of the timber.

There are, therefore, two questions involved in this case, with reference to which Mitchell Brothers Company claims:

First: That the timber which the company owned on December 31, 1908, was capital at its then fair market value, and that in the ascertainment of its income under the excise tax law, that market value could be deducted from gross receipts,

(a) Because it cannot be considered as any part of the gross amount of the income received within the taxing year,

(b) Because it is part of the manufacturing cost and deductible as such.

Second: That the books of the company are not conclusive or binding as to the value of its timber stumpage, but that the question of the value of such stumpage on December 31, 1908, is a question of fact to be determined from evidence submitted and not according to arbitrary figures used in the company's bookkeeping.

ARGUMENT.

The timber stumpage owned on December 31, 1908, and converted during the taxing years, was properly deducted from gross receipts at the market value which it had on that date:

A. Because it cannot be considered as any part of the gross amount of the income received within the taxing year; and

B. If it could be considered as any part of the gross amount of the income received within the taxing year, it was part of the manufacturing cost and deductible as such.

A.

The timber stumpage valued as of December 31, 1908, was not part of the gross amount of the income received.

First: Because it was not income at all, either gross or net, but was capital, and

Second: Even if part of the gross amount of the income, it was not *received* within the year.

(1) *The timber stumpage valued as of December 31, 1908, was capital, and was not income at all, gross or net, within the meaning of the law.*

The provisions of the Corporation Excise Tax Law, insofar as they are material to this controversy, are as follows:

> "Sec. 38. That every corporation * * * organized for profit and having a capital stock represented by shares * * * now or hereafter organized under the laws * * * of any state or territory of the United States * * * shall be subject to pay annually a special excise tax with respect to the carrying on or doing business by such corporation * * * equivalent to one per cent upon the entire net income over and above $5,000 received by it from all sources during such year, exclusive of amounts received by it as dividends upon stock of

other corporations * * * subject to the tax hereby imposed. * * * Second, such net income shall be ascertained by deducting from *the gross amount of the income of such corporation* * * * *received within the year from all sources* (first) all the ordinary and necessary expenses actually paid within the year out of income in the maintenance and operation of its business and properties, including all charges such as rentals or franchise payments, required to be made as a condition to the continued use or possession of property. (Second) All losses actually sustained within the year and not compensated by insurance or otherwise, including a reasonable allowance for depreciation of property, if any. (Third) Interest actually paid within the year on its bonded or other indebtedness, * * * not exceeding the paid up capital stock of such corporation * * * (Fourth) All sums paid by it within the year for taxes * * * (Fifth) All amounts received by it within the year as dividends upon stock of other corporations * * * subject to the tax hereby imposed". (U. S. Revised Stats. 1913, Sec. 6300 et seq.)

Since the passage of this law, this Court has held that it does not impose a tax upon incomes as such; that it is an excise tax upon the conduct of business in a corporate capacity, *the tax being measured by the amount of the net income,* as ascertained in the way provided in the act.

Anderson v. Broadway, 239 U. S. 69.
Flint v. Stone Tracy Co., 220 U. S. 107.
McCoach v. Minehill & S. H. R. Co., 228 U. S. 295, 306.
United States v. Whitridge, 231 U. S. 144, 147.
Stratton's Independence v. Howbert, 231 U. S. 399, 414.

The act, as above shown, provides that the "net income shall be ascertained by deducting from the *gross amount of the income* * * * *received within the year* from all sources" certain items. The act does not attempt to

define how "the gross amount of the income received within the year" is to be determined, or of what it shall consist; and the question of what is the "gross amount of the income received within the year", is therefore one of statutory construction.

The contention of the Government seems to be that the generally accepted meaning of the word "income" has nothing to do with the construction of this statute, and that a discussion of the terms "capital" and "income" is entirely foreign to the issue. This contention has been so well answered by the Circuit Court of Appeals of the Sixth Circuit in the recent case of *Biwabik Mining Co. v. United States* (May 8, 1917), 242 Fed. 9, that we quote the language of that Court:

> "It is urged that we are not concerned with the meaning of 'income', because under this statute, income is not the thing taxed, but is the measure of taxation. We do not appreciate the force of the claimed inference. 'Income' is a word capable of definition. Of course, its definition may cover a variety of specific meanings, and its context may determine which specific meaning should be accepted; but no reason has been suggested, and none occurs to us, why the mere fact that the term is used as a yardstick for measuring taxation or something else, rather than as describing the thing upon which the tax rests, should indicate that one or another specific meaning is the right one. It is well known that Congress was driven to tax the privilege (according to its value as indicated by its net income) because of the failure of the law taxing 'income' directly; and—to say the least—there can be no presumption that, between the old law and the new one, Congress had changed its idea of what the word 'income' meant. When reduced to final terms, to say that 'income', in this law, does not mean, generally, the same thing as it does in income tax laws, is to say that levying upon the income of a company a tax of 1 per cent will produce $10, while levying upon the franchise of that company a tax of 1 per cent of its

income may produce $12; and we cannot approve that proposition.

It would have been perfectly natural for Congress to decide that the tax which it was to impose upon the privilege should be measured either by the amount of business done thereunder or by the proved value of the privilege. Either would have been a logical basis for such taxation. If the former had been the adopted theory, the tax would have been measured by total receipts, or by total sales, or by total disbursements, or by some combination of these measurements, and any thought of profits would have been utterly foreign to the scheme of measurement. The most casual inspection of the law shows that this theory was not adopted. On the contrary, all ordinary expenses and losses in the conduct of the business were expressly to be deducted, and only the remainder was to be taxed. Whether this remainder happened to be called net income or net profits was a matter of no consequence; by either name it was the same thing. It is the essence of the law that a corporation doing a business of $100,000 and making $5,000 profit, is to be taxed 1 per cent upon that profit, less the exemption, or $450, while a corporation doing a business of $10,000,000 and making no profit is not to be taxed at all. It is clear to a demonstration that Congress deliberately intended to tax the franchise according to its actual value to the user, as determined by the annual profit derived therefrom, without regard to its value as indicated by the amount of business done.

So, too, it is urged that we should not be concerned with this definition, because the statute itself carefully defines what the tax upon income shall be. As has been pointed out, this idea rests upon a clear misapprehension of the statute; the law does not purport to do this or anything like this. The statutory computation rests upon the assumption that we already know what income is as distinguished from other matters; otherwise, it would be imposisible to state that gross income which is the foundation of that statutory computation.

We therefore are confirmed in our opening statement that, to rightly interpret this law, we must interpret and define 'income'. It must, by certain

attributes, be distinguished out of the mass, or from other things with which it is compared. Distinctive definitions involve contrast. Since the law specifies 'income', and not 'sales', or receipts', or 'capital and surplus', or any other standard of measurement which might have been named, what should be set over against 'income' to bring out this distinctive character? In every case in the Supreme Court and in the lower courts, including and since the Stratton's Independence Case, it has been assumed that the receipts and accumulations of a business corporation are of two classes: One, those which constituted its gross income; and the other, those which represented the sale or conversion of its capital—and the controversy has always been as to the respective definitions of those two classes. We accept this as the rightful criterion, not only because it has been universally accepted, but because we think it must be right. The only alternative is to say that all receipts from the conduct of a business according to its intended plan are income. To say this is to destroy the effect of carefully selected words. It would involve the conclusion that, in case of a company organized to buy land and subdivide and sell lots, all receipts from the sales of lots were 'gross income', even though the lots were all sold and the invested capital not realized, and that, since only disbursements made during the year can be deducted, the capital so invested in one year and realized the next year would be taxable net income. So far as words are concerned, it is impossible to say that the law did not intend to go to that very extent; but to say so would be such a departure from the administrative practice and rules which have prevailed from the beginning, and from what we think the law has always been assumed to mean that we are unwilling to take so radical a step".

"Gross amount of the income" does not mean "gross receipts", and it does not include what was capital on December 31, 1908.

We may well dispose, at the outset, of the contention now made by the government that "gross amount of the income" means "gross receipts".

Congress, by the use of the term "gross amount of the income", could not have meant "gross receipts". In the first place, Congress, had it intended any such far-reaching result, would have used appropriate language to effectuate that intention. It would have been a simple matter to have said "gross receipts", and it would have been the natural and reasonable thing for Congress to do. As a matter of fact, that is just what Congress did do ten years earlier when it wanted to levy an excise tax on *"gross receipts"*. It enacted the war tax act of June 13, 1898 (30 Stat. 448), which provided for a tax upon "the gross annual receipts (less a certain deduction) of any corporation or company carrying on or doing the business of refining sugar". (See Spreckles Sugar Co. v. McClain, 192 U. S. 397.) Congress wanted to tax "gross receipts" and it said "gross receipts". It must therefore be conclusively presumed that Congress, by the passage of the excise tax law of August 5, 1909, did not intend to tax "gross receipts", less certain deductions, or it would have said so, as it did in the war tax act of 1898.

And in the second place, the whole act shows very clearly and conclusively that Congress employed the word "income" in contra-distinction to the word "capital"; and that it was only upon "income" as distinguished from "capital" that the amount of the tax was to be based and calculated. In speaking of the gross amount of the income, Congress certainly did not intend that there should be included money received from the disposition or sale of assets, when none of such money represented "gain" or "profit" or "income" accruing during the taxing years, and represented only a change of the capital from one form to another.

That "gross amount of the income" does not mean "gross receipts", and that it does not include what was

capital on December 31, 1908, was the construction placed upon this law from the very beginning by the Governmental Department having its administration and execution in charge. In the first decision of the Treasury Department dealing with this subject and laying down rules for the guidance of collectors, the Treasury Department said:

> "It will be noted from these definitions that *gross income is practically the same as gross profits.*
>
> *Sale of Capital Assets* — In ascertaining income derived from the sale of capital assets, if the assets were acquired subsequent to January 1, 1909, the difference between the selling price and the buying price shall constitute an item of gross income to be added to or subtracted from gross income according to whether the selling price was greater or less than the buying price. If the capital assets were acquired prior to January 1, 1909, the amount of increment or depreciation representing the difference between the selling and buying price is to be adjusted so as to fairly determine the proposition of the loss or gain arising subsequent to January 1, 1909, and which proportion shall be deducted from or added to the gross income for the year in which the sale was made". (Treasury Decision No. 1571, dated Dec. 3, 1909.)

A little later the Treasury Department said:

> *"The return shall show the gross income (profit) received during the year* * * * .
>
> "The rules, as hereinafter stated, relative to manufacturing corporations also apply to mercantile corporations, and it is not at all material in making a return for the year 1909, if the goods were purchased prior to that time. *On January 1, 1909, the goods referred to constitute capital assets at the invoiced value, and only the profits on the same, if sold during the year, are taken as gross income,* or if not all sold during the year, gross income is found by an addition to the credit side of the account of the sum of the inventory at the close of the year". (Treasury Decision No. 1588, dated January 24, 1910.)

And on February 14, 1911, the Department laid down the rule:

> "If timber is disposed of through sales or otherwise it is to be accounted for in accordance with regulations governing *disposition of capital and other assets*". Treasury Decision No. 1675, Sec. 75.)

And, as a matter of fact, Treasury rulings *covering the entire period during which the law was in effect* treated the words "gross income" as not meaning "gross receipts", but as being used in contra-distinction to capital. The Department in all of its rulings made it plain to collectors that income meant "profit" and not "receipts"; and that *it did not include receipts which represented capital.*

Treasury Decisions Nos.

1571.
1588.
1606, Sections 50, 71, 72.
1675, Sections 37, 48, 55, 75, 80, 81, 83, 84, 85.
1706.
1727.
1742 Sections 43, 48, 55, 62, 78, 85, 86, 91, 97, 98, 99, 101, 102, 103, 104, 105.
1754.
1755.
1833.
2130.

A brief resume of these decisions, and we have been unable to find any others pertinent to this discussion, will be found in the Appendix to this brief.

While the rulings of the Treasury Department and the construction placed by that department upon the language used by Congress are not controlling, they are, nevertheless, significant and entitled to much force, par-

ticularly in view of the fact that such rulings were promulgated and, *to the extent stated, consistently reaffirmed during the entire life of the statute.*

It is well settled that the long-continued construction of a statute by the Department charged with its execution should not be overruled except for cogent reasons.

Schell v. Fauche, 138 U. S. 572.
Brown v. United States, 113 U. S. 571.
Iowa v. McFarland, 110 U. S. 471, 485.
Smythe v. Fiske, 23 Wall, 374, 382.
United States v. Railroad Co., 142 U. S. 615.
United States v. Hill, 120 U. S. 169.
United States v. McDaniel, 7 Pet. 1.
United States v. Hill, 120 U. S. 182.
Peabody v. Stark, 16 Wall. 240.
Hahn v. United States, 107 U. S. 406.
Railroad Co. v. Hooker, 233 U. S. 97, 118.

In *Schell v. Fauche,* 138 U. S. 572, this Court said on this point:

> "In all cases of ambiguity, the contemporaneous construction, not only of the courts but of the departments, and even of the officials whose duty it is to carry the law into effect, *is universally held to be controlling".* (Citing numerous cases.)

Not even in making the reassessment involved in the case at bar, did the Commissioner of Internal Revenue construe "gross amount of the income" as meaning "gross receipts", but permitted the company to deduct from its gross receipts, on account of stumpage consumed, the amount charged against the timber lands account on the books of the company at the rate of $2.25 and $8.00 per thousand, the Commissioner's theory being that such figures conclusively established the value of the stumpage as a capital asset.

In making the claim in the case at bar that "gross

amount of the income" was intended to mean "gross receipts", the Government not only denies the very principle upon which the reassessment in this case was based, but it takes a position antagonistic to *all the rulings* it has made and to *all of the instructions* it has issued pertaining to this feature of the law. The Treasury Department itself, whose practice it undoubtedly is to construe revenue laws most strongly against the taxpayer, has never even thought of making the claim the Government now makes, but on the contrary, it has again and again interpreted the law as making the measure of the tax the income *derived from capital,* and not *receipts representing capital.*

See Treasury Decisions above cited.

If the contention made by the Government in this case is sustained, it will mean that Mitchell Brothers Company, and a few other timber owners against whom additional assessments may have been levied, will be singled out from amongst the vast number of corporations, which, during the years from 1909 to 1912, when the excise tax law was in effect, paid to the government some twenty-five millions of dollars per year in excise taxes, *all of which were, under the express instructions and direct rulings of the Treasury Department, based, computed, levied and paid upon the theory that taxable income under the law did not include receipts representing what was capital on December 31, 1908.* Is it possible that the courts would be justified in now placing upon the extinct excise tax law a construction entirely at variance with and directly antagonistic to the construction which the Department charged with its administration and execution placed upon it during the entire life of the statute, *and upon which construction that Department based and levied excise taxes to the amount of over one hundred millions of dollars?*

But, aside from the force which should be given to the long-continued construction placed upon the statute by the Department charged with its execution, it is also clear that that construction is the only natural and reasonable one; and it is the one which has been adopted by such courts as have had occasion to pass upon the question. While the particular question involved the case at bar has not come directly before the courts in any other case, the general principle here in question as to whether "income" as used in the low means "income" or means "receipts" has been considered and the courts have treated the word "income" as being in no way synonymous with the word "receipts", *and as excluding capital assets belonging to the taxpayer on December 31, 1908.*

Industrial Trust Co. v. Walsh (Dist. Ct. Dist of Conn.), 222 Fed. 437.

Gauley Coal Co. v. Hayes (C. C. A. 4th Cir.), 230 Fed. 110; 144 C. C. A. 408.

Biwabic Mining Co. v. United States (C. C. A. 6th Cir.), 242 Fed. 9.

C. C. C. Ry. Co. v. United States (C. C. A. 6th Cir.), 242 Fed. 18.

Forty Fort Coal Co. v. Kirkendall (Dist. Ct. M. D. Pa.), 233 Fed. 704.

United States v. Guggenheim, 238 Fed. 231.

See also the following cases arising under the Income Tax Law of October 3, 1913, and laying down the same rule with reference to similar language in that act.

Toune v. Eisner (Jan. 7, 1918), U. S. Adv. op p.

Lynch v. Hornby (C. C. A. 8th Cir.), 236 Fed. 661; 149 C. C. A. 657.

Lynch v. Turrish (C. C. A. 8th Cir.), 236 Fed. 653; 149 C. C. A. 649.

Gulf Oil Corp. v. Lewellyn (Dist Ct. U. Dist. Pa.), 242 Fed. 709.

Southern Pacific Co. v. Lowe (Dist. Ct. S. D. New York.), 238 Fed. 847.

In Industrial Trust Co. v. Walsh (Dist. Ct. Dist. of Conn.), 222 Fed. 437, it was held that the net increase in the book value of securities held by a banking and trust company as an investment for surplus funds, as shown by an adjustment of such values entered on its books, such increase, in some instances extending over a number of years, does not constitute "net income" received by the corporation during the year in which the adjustment was made, within the meaning of the Corporation Excise Tax Law, and is not subject to the excise tax thereby imposed. The Court, in deciding the case, said in part:

> "Therefore the sole question in this case is whether the Commissioner was legally justified in assessing the tax of 1 per cent provided for in the act, on the net increase in value of the securities as shown by the book adjustment made by the plaintiff in June, 1912, and (as bearing upon that question, whether the increase in book value of such securities should be considered as 'income received by plaintiff during the year'.
>
> As a guide in answering this question reference is made to the Act of March 2, 1867, c 169, 14 Stat. 477, and the decisions following its passage. That act provided that:
>
> 'There shall be levied, collected and paid annually upon the gains, profits, and income of every person, * * * whether derived from any kind of property, rents, interest, dividends, or salaries, or from any other source whatever, a tax of five per centum on the amount so derived over $1,000, * * * and the tax herein provided for shall be assessed, collected, and paid upon the gains, profits, and income for the year ending the 31st of December next preceding the time for levying, collecting, and paying said tax'.

And further that:

'In estimating the gains, profits, and income of any person, there shall be included all incomes derived from interest upon notes, bonds and other securities of the United States, profits realized within the year from sales of real estate purchased within the year, or within two years previous to the year for which income is estimated, * * * and all other gains, profits, and income derived from any source whatever'.

Subsequent to the enactment of 1867, Gray v. Darlington, 15 Wall. 63, 21 L. Ed. 45, was decided by the Supreme Court and must, in my opinion, be decisive of this case. There the plaintiff was assessed, and paid under protest, the tax levied on an advance in the value of securities, and then brought suit to recover the amount paid.

In that case, the plaintiff, in 1865, was the owner of certain United States treasury notes which he exchanged for United States bonds. In 1869 he sold the bonds at an advance of $20,000 over the cost of the treasury notes, and the government levied on this advance the tax provided by the act as a 'gain', 'profit', or 'income' for the year in which the plaintiff sold the bonds.

At this point it should be noted that in the act of 1867 Congress made use of the terms 'gains', 'profits', and 'income', while in the act now under consideration the term 'net income' alone has been used upon which to assess the tax, and that further wording of the present act restricts the levy thereof to 'the entire net income, over and above five thousand dollars, received * * * from all sources during such year * * * '. Therefore the act of 1867 would appear, upon its face, to be much broader in its scope, so far as it concerns the taxing of what may be considered 'income', than the act of 1909.

Nevertheless, the Supreme Court of the United States, speaking by Justice Fields, in Gray v. Darlington, supra, said on page 66 of 15 Wall. (21 L. Ed. 45):

'The mere fact that property had advanced in value between the date of its acquisition and sale does not authorize the imposition of the tax

on the amount of the advance. Mere advance in value in no sense constitutes the gains, profits, or income specified by the statute. It constitutes and can be treated merely as increase of capital'.

And on page 65 of 15 Wall. (21 L. Ed. 45), that:

'The advance in the sale of property during a series of years can, in no just sense, be considered the gains, profits, or income of any one particular year of the series, although the entire amount of the advance be at one time turned into money by a sale of the property'.

After careful consideration of the facts in this case and the close analogy they bear to the facts in Gray v. Darlington, supra, I must conclude that the same interpretation given to the statute of 1867 by the Supreme Court, with reference to what was taxable as income under that statute, must be given to the act of 1909".

The case of *Gauley Mountain Coal Co. v. Hayes,* decided by the Circuit Court of Appeals for the Fourth Circuit on December 2, 1915, arose under the Corporation Excise Tax Law, and involved facts very similar to those involved in the well known case of *Gray v. Darlington* hereinafter referred to. The rule laid down by this Court in *Gray v. Darlington* was held applicable to the Corporation Excise Tax Law. The facts in the Gauley case were as follows:

On December 9, 1902, the Gauley Mountain Coal Co. purchased 8,000 shares of stock of another mining company for $800,000. It held this stock (at first in the name of trustees, but later in its own name) for nearly nine years. On October 16, 1911, it sold the stock for $1,010,000. This was a sum greater by $210,000 than its cost. Upon these facts being ascertained, the Commissioner of Internal Revenue held that the $210,000 received for the stock in excess of its cost represented income derived from the stock, and that the proportion of

this income represented by the ratio of time which elapsed betweenJanuary 1, 1909, when the Corporation Excise Tax Law became effective, and October 16, 1911, when the sale was made, to the time which elapsed between September 9, 1902, when the purchase was made, and October 16, 1911, when the sale was made, to-wit, $66,189.30, constituted "income" of the corporation for the year 1911 within the meaning of that word as used in the Corporation Excise Tax Law. An additional assessment was levied by the Commissioner on this basis, which was paid and suit was brought to recover the amount exacted.

The District Court in which the suit was brought sustained the assessment, but the Circuit Court of Appeals reversed the decision of the District Court, and held that none of the increase in value of the bonds was taxable income within the meaning of the law. The Circuit Court of Appeals, in deciding the case, said in part:

> "As we have stated, the property in question was purchased on the 9th day of December, 1902, and not disposed of until the 16th day of October, 1911, at which time the plaintiff was able to dispose of it at a profit of $210,000. Therefore, the principal question in this controversy to be determined is as to whether the increase in value of the property which accrued during such period, was subject to taxation as the entire net income of the plaintiff. * * *
>
> It is manifestly the purpose of this Act to tax the net income for the year in which the assessment is made. The Supreme Court in the case of Gray v. Darlington, 82 U. S. 63, passed on the precise question involved in this controversy. That case was decided under the amendatory Internal Revenue Act of March 2, 1867. The plaintiff being the owner of certain United States Treasury notes exchanged them in 1865 for United States 5-20 bonds. In 1869 these bonds were sold at an advance of $20,000.00 over the Treasury notes which had been given in exchange, and were assessed upon this amount as gains, profits and income for that year".

After quoting from the opinion of the Court in *Gray v. Darlington*, the Circuit Court of Appeals continues:

> "The defendant relies upon the cases of *Flint v. Stone Tracy Company*, 220 U. S. 107, and *McCoach v. Minchill & S. H. R. Company*, 228 U. S. 300. We have carefully considered these cases but find nothing therein which modifies the decision of the Supreme Court in the case of *Gray v. Darlington, supra*, insofar as this phase of the question is concerned. The Supreme Court in the cases cited by defendant, among other things, held that any gains or profits accruing from investments in real estate or other property incidental to the business in which a corporation may be engaged are subject to taxation, and to this extent the case of *Gray v. Darlington, supra*, is modified. Therefore, according to the rule therein announced, if the plaintiff in this instance had purchased and sold real estate within the year for which the assessment was made any profits realized therefrom would be subject to taxation".

In *Biwabic Mining Co. v. United States*, 242 Fed. 9, the Circuit Court of Appeals for the Sixth Circuit had before it the following question in connection with the income from certain mining operations:

> "So far as the selling price of the ore in 1910 represented its actual value to the company in the ground on January 1, 1909, was it income or was it the sale price of capital assets?"

The Court in holding that the value of the ore in the ground on January 1, 1909, *which value had been agreed upon between the parties to the suit*, was capital to the extent of such value and not income within the meaning of the law, said in part:

> "In its general aspect, this question is the same as that discussed in Doyle v. Mitchell. (We may here refer to that opinion, without repeating it at length, for the matters there stated. Unless that case was wrongly decided, the question must be whether this case is to be distinguished in principle. Certainly there is no great difference in the inherent character

of the assets transferred and sold. The ore below the surface and the trees above were interests in realty until they were severed. Upon severance and preliminary treatment, each became the raw material for further process of manufacture. The extent and quality of each before severance were determined by expert appraisal. Each, before severance, had a known and realizable market value. Each had been purchased in its unsevered form by the company taxed, and each, while still in that form, had increased in market value after the purchase and before the law was passed, and had then further increased before severance, and in each case the market value when the law went into effect had been ascertained and stated accurately and in good faith. What are the distinctions urged?

The first is that the company was a mining company, and not a manufacturing company. The law makes no such distinction, and there can be no magic in the word 'mining' as part of a corporate name. Where a mining business is of the character described in the Stratton's Independence Case, it is clear enough that there is great, if not insuperable, difficulty in ascertaining the value of the ore in the ground at a fixed date. The whole subject may well be thought too speculative to justify attributing to 'depletion of capital' any ore which has been removed. The annual operations of such a mine are expected to and often do develop new ore bodies of even greater value than those removed. Not only are the value and the extent of the ore in place unknown, but the cost of removal is highly uncertain, since it will depend upon unknown and constantly changing conditions. The same considerations apply more or less perfectly to the gas and oil operations and to the coal mining which have been considered in decided cases. These things are so typical of mining operations, as a class, that perhaps we should apply to everything belonging in that general class a general rule which will prevent an appraisal of the ore in place as a capital asset at the beginning of the period. *The present case does not belong in that class. The parties have stipulated to the extent and value of the ore in the ground on January 1, 1909.* Nothing could be more definite or certain.

As was said in the statement of facts, this was a quarrying operation. It involved no elements of uncertainty, except those future contingencies which affect the value of all raw material. In spite of the name of the company, the business more nearly approximated manufacturing than it did mining, as the latter term is commonly understood".

The Court distinguished the Sargent Land Company case as follows:

"Finally, it is urged that this case is controlled by the decision of the Supreme Court in the Sargeant Land Company Case. The mining leases involved in that case and in this one seem to be identical in substance, and it is now said with great plausibility that the ore in the ground and affected by such a lease belongs partly to the lessor and partly to the lessee, and that, if the interest of the lessor is not capital assets, no more is the interest of the lessee, and that, if the receipts of the former are income, so must those of the latter be. We are convinced that the analogy between the two cases is superficial and not substantial. In that case the Supreme Court had to determine whether the royalties received by the lessor were income or were a depletion of capital. Many considerations led to the conclusion that they must be treated as income. The contract was a 'lease', the receipts were 'royalties', and royalties, being rentals, are inherently income, and have been commonly so considered. All these things seem to have affected the conclusion of the court, but, after all, the dominating thought appears to be that, when land is devoted to mining, it is put to only one of those productive uses of which it is capable, and that the product of the use should be called income. The land itself is the chief thing; after the mining is finished, the land remains suitable for other uses; and the fact—if it is a fact—that the minerals are the greater part of its value cannot operate to make the incidental overshadow the principal. These reasons do not apply at all to the case of the lessee whose existing interest, at the beginning of the taxing period, over and above the royalty which he must pay, amounted to $3,000,000; his entire interest was each year, as far as he went, consumed and ex-

hausted forever; he did not have remaining the principal thing, the land, which he could put to some other use; the receipt in 1910 of his January 1, 1909, interest in the ore was not the offshoot and income of his property; it was the transformation and eating up of the very property, and of the whole of it. We therefore think that applying the principle of the Sargeant Case results in holding that these receipts were from the sale of capital assets and not from income".

In *Cleveland & C. C. & St. L. Ry. Co. v. United States* (C. C. A. Sixth Circuit), 242 Fed. 18, another case under the Act of 1909, it appeared that the company had purchased 30,000 shares of Chesapeake & Ohio stock in 1900 and had sold the stock on January 28, 1909, at a large profit. The stock had a fixed market value on December 31st, 1908. The company did not include any portion of this profit in its return for the year 1909 and the Government brought suit to recover the tax and succeeded in the lower court. The Circuit Court of Appeals reversed the judgment except as to so much of the profit as was represented by the increase in value between January 1, 1909, and January 28, 1909.

The Court, referring to its decisions in *Doyle v. Mitchell* (*supra*) and *Biwabik Mining Co. v. United States*, 242 Fed. 9, said:

> "In those cases we have given the reasons for our conclusion that the sum received during 1909 for capital assets sold during that year cannot be considered as income under this Act, excepting to the extent by which it exceeds the ascertained market value of those assets on January 1st of that year. The principles discussed and adopted in these cases necessarily lead to the reversal of this judgment, excepting with regard to the increased value which accrued after January 1st".

In Towne v. Eisner, decided January 7th last, this Court held that under the Income Tax Law of October 3,

1913, stock dividends resulting from a capitalization of surplus earned prior to January 1, 1913, when the law became operative, were not income but were a mere distribution of the capital existing at the date of the first incidence of the tax.

In principle this case is squarely in point. Neither the Income Tax Law of October 3, 1913, nor the Corporation Excise Tax Law here involved expressly defines the meaning of the term "income", and under both laws this meaning is a matter of statutory construction. In the Towne case this Court says that the "corporation is no poorer and the stockholder is no richer than they were before" the stock dividend was declared. In the case at bar Mitchell Brothers was no richer and no poorer on January 1, 1909, when the Corporation Excise Tax Law became operative, than it was on December 31, 1908, and when the Company cut, manufactured and sold its stumpage during the year 1909 it became no richer than it was on December 31, 1908, *except* by the profit derived from the manufacture and sale of the timber and by its increase in value since that date. As already shown, it accounted to the government for these additional items as income. It did not account to the government for the value of the timber on December 31, 1908, because that value, when translated into money at a later date, did not make the company either richer or poorer and gave it no "income" or "profit" which it did not already have on December 31, 1908. The company had the timber on December 31, 1908, and it was "money or money's worth" at its value on that date because, as found by the trial court, it had a definitely ascertained market value—it was equivalent to that much cash on hand because by sale on the stump it was capable of reduction to cash without further time or energy being expended upon it.

If the stock dividend in Towne v. Eisner was not income because merely a distribution of capital existing at the date the taxing law became operative, the value of Mitchell Brothers' stumpage on December 31, 1908, when converted into money at a later date, was also nothing more than a change in the form of the assets existing at the date the taxing law became operative.

The case of Lynch v. Turrish (C. C. A. Eighth Circuit), 236 Fed. 653, arose under the Income Tax Law of October 3, 1913, and the question related to the income of a stockholder. It appeared that the Payette Lumber & Mfg. Co. of which Turrish was a stockholder, had invested prior to March 1, 1913, in timber lands. The value of its assets on that date was not less than $3,000,000. There had been a gradual increase in the value of the timber lands from the time of their acquisition in 1903, and on March 1, 1913, Turrish's stock was worth twice its par value. In December, 1913, the property was sold to a new corporation, the Boise-Payette Company for $3,000,000 in cash and transfer was consummated in March, 1914. The Payette Company then distributed the $3,000,000 among its stockholders who surrendered their stock and Mr. Turrish received $159,950, which was twice the par value of his stock. The Commissioner of Internal Revenue deemed one-half of this sum to be capital and the other one-half to be income derived by him in 1914 from the dividend then received, and assessed an addition income tax accordingly, which Turrish paid under protest and sued back to recover.

The Court sustained his recovery, holding that the distribution was not income. The Court, by Sanborn, J., said:

> "*All the value of the property of the corporation and all the value of the stock of the plaintiff, whether it was due to capital assets, or income, or gains, or profits, or all of these combined, had arisen and accrued and had become their property* before March

1, 1913 * * *. The provisions of this law (referring to the provisions as to the period for which the tax should be levied) leave no doubt that the Congress intended to and did exclude from the burdens of the taxes it imposed by the Income Tax Act of October 3, 1913, *all income, gains, and profits of every kind which had arisen or accrued prior to March 1, 1913.* It surely intended to leave, and surely did leave, all the income, gains, and profits which had accrued or arisen prior to that date, whether they were in the form of divided or undivided surplus, income, gains, or profits, as free from every income tax it imposed, and as absolutely the property of their respective legal and equitable owners, as was any of their original capital or property. Now the subsequent change, by sale, distribution, or otherwise, of the form of property held on March 1, 1913, without thereby enhancing its value, or causing any gain, profit, or income to its holders, as from real to personal property, or from stock to cash, does not subject it to the income tax, because it produces no gain, profit, or income; it leaves the value of the property the same after as before the change And as the sale of the property of the Payette Company in 1914 and the distribution of its proceeds to its stockholders by the dividend did not enhance the value of the property of the corporation or of the stockholders, or produce any gain, profit, or income for them, but left the value of their property the same that it was before those transactions, and the same as it was when the Income Tax Law took effect, the declaration and payment in 1914 of the dividend by which the proceeds of the sale of the property of the corporation were distributed to its stockholders did not transform the increased value of the plaintiff's stock, which had accrued and arisen prior to March 1, 1913, into income, gains, or profits accruing or arising subsequent to that date and did not subject it to any income tax".

See also:

Lynch v. Hornby (C. C. A. 8th Circuit), 236 Fed. 661.

Forty Fort Coal Co. v. Kirkendall (Dist. Ct. M. D. Pa.), 233 Fed. 704.

In *Southern Pacific v. Lowe* (District Court S. D. N. Y.), 238 Fed. 847, a case under the Income Tax Law of October 3, 1913, involving certain extraordinary cash dividends received by a stockholder in 1914, the Court said:

> "I do not think that income as used in the statute should be given a meaning so as to include everything that comes in. The true function of the words 'gains' and 'profits' is to limit the meaning of the word 'income' and to show its use only in the sense of receipts which constituted an accretion to capital. So the function of the word 'income' should be to limit the meaning of the words 'gains' and 'profits'. The increased value of capital as such constitutes in one sense a gain or profit, but not income. Hence, such gain or profit is not taxable but only such profits and gains as constitute income are taxable".

See also:

Gulf Oil Corp. v. Lewellyn (Dist. Ct. W. Dist. Pa.), 242 Fed. 709.

In *United States v. Guggenheim Exploration Co.* (Dist. Ct. S. D. N. Y.), 238 Fed. 231, a case arising under the Corporation Excise Tax Law of August 5, 1909, it was held that the amount received from the sale of stock owned by a corporation and carried on its books at a value of one dollar was not taxable as income, where the evidence showed that the stock had a greater value, the Court saying:

> "From these quotations of the act in question here (the section of the law hereinbefore set forth) it is evident that the tax is to be measured by the net income from all sources received within the year. The fundamental question, and all-important one, is: Was this sale a profit income from any sources received within the year?
>
> What is income? The flow of capital's service is its income. A disservice is a negative service. A flow of disservice or negative income is called 'outgo'. The income of our capital is that which it does

> for us. * * * The word 'income' is not synonymous with the word 'receipts'. Von Baumbach v. Sargent Land Co., 219 Fed. 31. Income as used in the statute must be considered in contradistinction to property and invested capital. It is manifestly the purpose of the statute to tax the net income for the year in which the assessment is made".

In these cases the courts have held, in line with our contention in this case, that the law seeks to measure the tax by the amount of the net income, and that such *net income* cannot include what was capital on January 1, 1909, when the law became operative.

While this is the rule laid down in all of the cases cited, most of these cases also involved other questions not connected in any way with and not necessary to a decision of the case at bar. These other questions have necessarily resulted in some difference of judicial opinion which does not affect in any way the authority of these cases on the general principles here involved or their applicability to this case. We are, of course, not concerned here, as in some of the cases cited, with what is the taxable income of a stockholder or of a mining company. We are concerned merely with the taxable income of a lumber company owning property of a known and definitely ascertained value at the date of the first incidence of the tax, and disposing of such property during the taxing year.

The cases above cited, in holding that "gross amount of the income" does not mean "gross receipts", and does not include what was capital on December 31, 1908, have done nothing more than to apply to the statute its natural, reasonable and logical meaning.

The word "income" is not a new word in the terminology of tax legislation. It was used by Congress in previous revenue acts, and as so used it was construed by the courts before the passage of the Corporation Excise Tax Law of August 5, 1909. It had a well-defined

meaning in tax legislation when Congress passed that law, and it must be presumed that Congress had that well-defined meaning in mind. The usual rule is that when a word which has received judicial construction is subsequently used in Federal legislation it should be presumed to have been used in the sense determined by the courts. (Kepner v. United States, 195 U. S. 100, 124; Latimer v. United States, 223 U. S. 501, 504.) It cannot be presumed that Congress used the word "income" as synonymous with the word "receipts", and the contrary must be presumed in the light of constructions previously placed upon it. "Income" is not "receipts". Receipts might include money derived from the sale of assets; income cannot include such money where it represents nothing more than a change in the form of the assets. That money received from the sale or disposition of capital assets acquired prior to January 1, 1909, no part of such money representing gains, profits, or income accruing during the taxing years, cannot be considered as any part of the income under the law, gross or net, is clearly settled by the following authorities:

Gray v. Darlington, 82 U. S. (15 Wall.), 63.
Bailey v. Railroad Co., 106 U. S. 109.
Merchants Fire Ins. Co. v. McCartney, Fed. Cas. No. 9443 (1 Lowell 447).
C. B. & Q. R. Co. v. Page, Fed. Cas. No. 2668 (1 Biss 461).
Reynolds v. Williams, Fed. Cas. No. 11734 (4 Biss. 108).

Gray v. Darlington, 82 U. S. (15 Wall.) 63, arose under the income tax law of March 2, 1867 (14 Stat. 477, 478), which imposed a tax upon "the gains, profits and income of every person * * * whether derived from any kind of property, rents, interest, dividends or salaries,

etc., * * * or from *any other source whatever*". The act provided that:

> "In estimating the gains, profits and income of any person, there shall be included all incomes derived from interest upon notes, bonds and other securities of the United States, profits realized within the year from sales of real estate purchased within the year, or within two years previous to the year for which income is estimated, * * * and all other gains, profits and income derived from any source whatever".

The facts in the case were these, as stated in the opinion of this Court: In 1865 the plaintiff, being the owner of certain United States treasury notes, exchanged them for United States 5-20 bonds. In 1869 he sold these bonds at an advance of $20,000 over the cost of the treasury notes, and upon this amount the assistant assessor of the United States for the Collection District within which the plaintiff resided assessed a tax of 5 per cent, alleging it to be gains, profit and income of the plaintiff for that year. This Court held that the advance in the value of the property during a series of years did not constitute gains, profits or income of any particular year of the series, although the entire amount of the advance was at one time turned into money by a sale of the property—that mere advance in value constituted and must be treated merely as increase of capital. This Court, after stating the facts, said:

> "The question presented is whether the advance in the value of the bonds, during this period of four years, over their cost, realized by their sale, was subject to taxation as gains, profits, or income of the plaintiff *for the year in which the bonds were sold.* The answer which should be given to this question does not, in our judgment, admit of any doubt. The advance in the value of property during a series of years can, in no just sense, be considered the gains, profits, or income of any one particular year of the series, *although the entire amount of the advance be*

at one time turned into money by a sale of the property. The statute looks, with some exceptions, for subjects of taxation only to annual gains, profits, and income. Its general language is 'that there shall be levied, collected, and paid *annually* upon the gains, profits, and income of every person', derived from certain specified sources, a tax of five per cent, and that this tax shall be 'assessed, collected, and paid upon the gains, profits, and income for the year ending the 31st of December next preceding the time for levying, collecting, and paying said tax'. (14 Stat. at Large, 477-8, Sec. 13.) This language has only one meaning, and that is that the assessment, collection, and payment prescribed are to be made upon the annual products or income of one's property or labor, or such gains or profits as may be realized from a business transaction begun and completed during the preceding year. There are exceptions, as already intimated, to the general rule of assessment thus prescribed. One of these exceptions is expressed in the statute, and relates to profits upon sales of real property, requiring, in the estimation of gains, the profits of such sales to be included where the property has been purchased, not only within the preceding year, but within the two previous years. Another exception is implied from the provisions of the statute which requires all gains, profits and income derived from any source whatever, in addition to the sources enumerated, to be included in the estimation of the assessor. The estimation must, therefore, necessarily embrace gains and profits from trade and commerce, and these, for their successful prosecution, often require property to be held over a year. In the estimation of gains of any one year the trader and merchant will, in consequence, often be compelled to include the amount received upon goods sold over their cost, which were purchased in a previous year. Indeed, in the estimation of the gains and profits of a trading or commercial business for any one year, the result of many transactions have generally to be taken into account which originated previously. Except, however, in these and similar cases, and in cases of sales of real property, the statute only applies to such gains, profits, and income as are strictly

acquisitions made during the year preceding that in which the assessment is levied and collected.

The mere fact that property has advanced in value between the date of its acquisition and sale does not authorize the imposition of the tax on the amount of the advance. Mere advance in value in no sense constitutes the gains, profits, or income specified by the statute. It constitutes and can be treated merely as increase of capital.

The rule adopted by the officers of the revenue in the present case would justify them in treating as gains of one year the increase in the value of property extending through any number of years, through even the entire century. The actual advance in value of property over its cost may, in fact, reach its height years before its sale; the value of the property may, in truth, be less at the time of the sale than at any previous period in ten years, yet, if the amount received exceed the actual cost of the property, the excess is to be treated, according to their views, as gains of the owner for the year in which the sale takes place. We are satisfied that no such result was intended by the statute".

Bailey v. Railroad Co., 106 U. S. 109, arose under the income tax law of June 30, 1864, as amended by act of July 13, 1866, and involved the taxation as income of interest certificates issued by the railroad company in 1868. These interest certificates were issued to stockholders because, as stated in the resolution authorizing the issue, "the company has heretofore expended of its earnings for the purpose of constructing and equiping its road and in the purchase of real estate and other properties, moneys equal in value to 80 per cent. of the capital stock of the company", and because the stockholders were entitled to "some evidence of such expenditure and to reimbursement at some future period". The Government sought to tax the certificates of stock on the ground that they constituted a scrip dividend within the meaning of Section 122 of the Act of 1864 (13 Stat. p. 284), which provided for a tax of 5 percent. on certain companies "that

may have declared any dividend in scrip or money due or payable to its stockholders as part of the earnings, profits, income, or gains of such company", and "on all profits of such company, carried to the account of any fund or used for construction". It appeared that the earnings stated in the resolution to have been expended accrued during a period of fifteen years—from 1853 to 1868—of which only six years were covered by the income tax law. It was held that the certificates were a proper subject of taxation (as held in Bailey v. Railroad Co., 89 U. S. (22 Wall.) 604, reversing same case (Fed. Cas. No. 10203), but that the certificates were not conclusive as against the company as to the amount of taxable earnings represented by them—that the company could show what proportion of the earnings thus divided were earned during the years the income tax law was in effect, and that only that portion was subject to the tax. This Court held the amount need not be apportioned according to the years during which it was earned and the years the income tax law had been in effect, but that the company had the right to show just what part of the earnings accrued during the years the income tax law was in effect, and that, upon that alone, the tax must be paid for the years in which the income was actually distributed by the issue of these interest certificates. This Court, in passing upon the question, said in part:

> "It should be borne in mind in the first place, that the tax provided for in this section is an annual income tax, and its subject is the interest paid and profits earned by the company for each year, and year by year; and that both by the express letter of the law, and its necessary implications, *the tax is not laid on any of these funds which came into being before the time prescribed in the act*".

Merchants Fire Insurance Co. v. McCartney, Fed. Cas. No. 9443, arose under the income tax law of June 30, 1864

(13 Stat. 281), imposing a tax on all "dividends thereafter declared due as part of the earnings, income, or gains of any insurance company, and on all undistributed sum or sums made or added during the year to their surplus or contingent funds". An insurance company which was a stockholder in a bank had received a dividend from the bank, 3/10 of which was made out of profits accumulated before the passage of the income tax law, and 7/10 from profits acquired afterwards. *The Court held that the 3/10 was capital at the time the law went into effect and was not taxable as income, though distributed afterwards.* The Court said in part:

> "As to the three-tenths, it seems to me to have been a division of capital, a return to the plaintiffs in money of a part of the property which was already in their ownership as capital stock when the first tax act was passed. If the Suffolk bank had been wholly wound up and had returned to its stockholders the exact value of their shares in money, having made no profits since the passage of the original act, the sum of money could not be taxed as income, gains, or profits, and so of a part. If the plaintiffs on receiving the money chose to divide it among their own stockholders, still it is not a dividend out of gains and profits, or out of the surplus funds, because the surplus funds that are taxable are those which are or have been made out of the profits since the passage of the act".

In the case of *C. B. & Q. R. R. Co. v. Page*, Fed. Cas. No. 2668, which arose under the Act of July 1, 1862 (12 Stat. 469), the railroad company had from time to time, prior to 1862, made advances to another railroad, taking mortgages therefor. After the passage of the act the mortgages were foreclosed and stock certificates were issued to stockholders representing their pro rata interest in the property acquired. It was held that the stock thus issued did not constitute "dividends due and pay-

able during the year 1862", it being capital when the law went into effect.

Reynolds v. Williams, Fed. Cas. No. 11734, arose under the income tax law of 1864 (14 Stat. 478), providing for a tax upon "the gains, profits and income" derived from any source whatever. It was held that under that law a fund in the hands of a trustee for the use of stockholders which had been turned over to the trustee in 1867 upon the consolidation of one railroad with another, the said fund being accumulated earnings of the railroad company up to and prior to 1863, could not be taxed, the fund accruing to the stockholders by the transfer to the trustee not representing gains, profits or income for the year 1867.

See also,

People Ex Rel. Cornell University v. Davenport, 30 Hun. 177, 184. (Modified on other grounds, 117 N. Y. 549.)

The case of *People Ex Rel. Cornell University v. Davenport* did not involve the provisions of any income tax law, but it did involve a determination of what portion of the interest received on bonds which had been purchased at a premium should be considered "income" and what portion should be considered "capital" under an act of the State of New York appropriating the "income, revenue and avails which shall be received from the investment of the proceeds of the sale (of certain lands) to Cornell University". Between October 1, 1882, and February, 1883, the comptroller purchased with moneys belonging to a certain fund, United States four per cent bonds of the par value of $200,000 payable in 1907, paying therefor something over $238,000, the sum in excess of $200,000 being paid for accrued interest, premiums and commissions. The comptroller charged the sum of $200,000 to principal and $38,000 to the income of

the fund, thereby largely overdrawing the latter account. The University, claiming to be entitled to five per cent on the principal of the fund held by the comptroller, whether the fund earned that amount or not, applied for a mandamus to compel the comptroller to pay over to it such five per cent, after deducting payments already made. The comptroller claimed that he should make no payments until the income account had made itself good. It was held that the University had a right to receive only the actual income of the fund; and that that *actual income was the amount which the fund earned, remaining itself intact.* The Court, in discussing the question of what was actually the income from the fund, said:

> "The question for the relator is, what under the circumstances is the actual income of the fund. The income from an investment is that which it earns, remaining itself intact. * * * It is a common matter with bankers and dealers in stocks to compute by the aid of tables, what the actual income is, of a stock running a certain definite time, for which a certain premium is paid. That actual income is plainly less than the amount yearly received, because the premium paid must be so distributed, in the calculation, over the time the stock has to run, that the owner at the end of the time will have his original investment unimpaired. Otherwise though he may not notice this) he will have been gradually impairing his capital; in fact, using it up in the form of income".

And see the following authorities holding that, as between the life tenant and the remainderman, an increase is the value of stock is an accretion to the capital and not a part of the income.

Mercer v. Buchanan (1904), 132 Fed. 501, 507.
Gibbons v. Mahon, 136 U. S. 549.
Armitage v. Garnett, 3 Ch. Div. (1893), 337, 347.
Mills v. Button, 64 Conn. 4, 29 Atl. 236.
Miller v. Payne, 150 Wis. 354, 378.

Gibson v. Cook, 1 Metc. 75.
Cross v. Trust Co., 75 Hun. 533, and cases cited.
Smith v. Hooper, 95 Md. 27.
Appeal of Earp, 28 Pa. 368, 375.
Appeal of Wiltbank, 64 Pa. 256, 259.
In re Graham's Estate, 198 Pa. St. 216.
Oliver's Estate, 136 Pa. St. 43.
Venatter v. Carr, 229 Ill. 47.
Re Park's Estate, 173 Pa. St. 190.
Spooner v. Phillips, 62 Conn. 62; 24 Atl. 524.
Smith v. Hooper, 95 Md. 16; 51 Atl. 844, 846.

Attention may also be called to the fact, and it is an important fact, that the word "income" had a well settled meaning at the time of the passage of the excise tax law, not only in a legal sense, but also in a general sense. The language used by Congress must certainly be interpreted in the light of common understanding and of common usage. (United States v. Isham, 17 Wall. 496, 504.)

What did Congress mean when it used the words "gross amount of the income" and "net income"? It must be conceded that Congress did not intend, in the use of these words, to have them construed as meaning something which they had never meant before. It must be conceded that Congress intended they should be used in their ordinary and common meaning; and that ordinary and common meaning excludes receipts obtained from the sale or conversion of capital.

Funk & Wagnalls New Standard Dictionary (1913).
Century Dictionary Encyclopedia (1911).
Seligman on the Income Tax (1911).

Funk & Wagnalls New Standard Dictionary gives the following definitions:

Gross Income—

The entire receipts or revenue derived *from* a business, investment, property, etc., before any expenditures, such as payment of taxes, wages, insurance, etc., are made out of it.

Income—

The amount of money coming to a person or corporation within a specified time or regularly (when unqualified annually), whether as payment for services, interest or profit *from* investment; revenue.

Net Income—

The residue of the gross income *from* any business, property, etc., after all contingent expenses have been paid.

The Century Dictionary Encyclopedia (1911) gives the following definition:

Income—

That which comes in to a person, as payment for labor or services rendered in some office, or as gain *from* lands, business, the investment of capital, etc.; receipts or emoluments regularly accruing, either in a given time or, when unqualified, annually; the annual receipts of a person or a corporation; revenue: As an income of $5,000; his income has been much reduced; the income from the business is small.

Synonyms—Income, revenue, value, profit. Revenue is the income of a government or state, without reference to expenditures; profit is the gain made upon any business or investment when both the receipts and the expenditures are taken into account. *Property may have value and yield neither income nor profit.*

Seligman in his work on the Income Tax, published in 1911, defines income in the following language:

"Income is, of course, to be distinguished from mere receipts or gross revenue. It is more than that which simply comes in from any economic activity. Income has always meant net income, as opposed to gross income. In other words, from the receipts of any enterprise we must, in the first place, deduct the expenses of the enterprise—that is, the outlay incurred in securing the gross product. But, secondly, income has a personal categorical difference from net product. If a debt has been contracted in order to secure the produce of a given piece of property or of a given enterprise, the interest on the debt must be deducted. Finally, in the outlays or expenses which have been incurred to secure the product, there must also be included a compensation for wear and tear of plant; just as the investor in securities computes his actual income by deducting an amortization quota from the annual proceeds. *Income, therefore, always means net income*".

"What has been stated is equivalent to saying that income is that which comes in to an individual above all necessary expenses of acquisition, and which is available for his own consumption. Since the income is a flow of wealth, it must always be estimated for a definite period, so that when we speak of income for purposes of taxation, we really mean annual income. Strictly speaking, income as contrasted with capital denotes that amount of wealth which flows in during a given period and which is at the disposal of the owner for purposes of consumption, so that in consuming it, *his capital remains unimpaired*. The problem, however, of defining income with such precision as completely to avoid any net impairment of capital is one which almost baffles the student, and certainly no such precision can be attained for purposes of taxation. Again, just as on the other hand, *income does not comprise those elements which constitute an impairment of capital*, so on the other hand income ought not to be conceived as including those merely temporary elements which constitute an addition to capital".

Seligman on the Income Tax (1911, p. 19).

Income as defined by Webster is "that gain which proceeds *from* labor, business, property or capital of any kind, as the proceeds of a farm, the rent of houses, the proceeds of professional business, the profits of commerce or of occupation or the interest of money or stock, especially the annual receipts of a private person or a corporation *from* property".

Remington v. Field, 16 R. I. 509; 17 Atl. 551, 552.

The word "income" has a broader meaning than "dividend"; *but hardly broad enough to include things not separated in some way from the principal.* It is not synonymous with "increase". Value of stock may be increased by good management, prospects of business and the like; but such increase is not income.

Spooner v. Phillips, 62 Conn. 62, 24 Atl. 524.
Mills v. Button, 64 Conn. 4; 29 Atl. 231, 236.
Smith v. Hooper, 95 Md. 16; 51 Atl. 844, 846.

Applying to the case at bar the general principle of the cases which have been discussed and the principles of statutory construction referred to, it follows that there is no escape from the conclusion that the value, on December 31, 1908, of the company's timber stumpage was properly deducted in arriving at the amount of the net income which was the measure of the tax under the law.

Mitchell Brothers Company owned all of its timber lands on December 31, 1908. On that date, such lands had a certain market value. No one would claim that on December 31, 1908, such lands at their then market value represented anything but capital. No one would claim that they represented income. During the years 1909, 1910, 1911 and 1912, the timber on these lands was manufactured into lumber, and the lumber was sold for cash or its equivalent. *The company accounted to the Govern-*

ment for all the profits derived from the manufacture and sale of the timber, and it also accounted to the Government for all the increase in value which accrued after December 31, 1908. It claims that it need not account to the Government, in the way of income, for the value which the timber stumpage had on December 31, 1908, because as to such value the amount received was capital, and not income. The form of the company's assets was changed during the taxing years from timber stumpage into lumber, and from lumber into money or credits. By this conversion the capital did not, merely because the form was changed, cease to be capital and become income.

To hold otherwise is to make arbitrary and unjust distinctions between the taxpayer who owns his timber on December 31, 1908, and the one who acquires his timber on January 1, 1909, the next day, or on any subsequent date. To illustrate this is to establish the absudity, injustice and unreasonableness of the resulting situation.

Company A owns $100,000 in cash on December 31, 1908, and buys $100,000 worth of timber on January 1, 1909. It manufactures that timber during the year and sells its products for the gross amount of $200,000. Its manufacturing, operating and selling expenses, including the purchase price of its raw materials (the timber) are $175,000. Its profits at the end of the year are $25,000, and its original capital of $100,000 is unimpaired. Under the provisions of the excise tax law, its taxable income is exactly $25,000.

Company B owns or purchases $100,000 worth of timber lands on December 31, 1908. It manufactures that timber during the year 1909, and sells the products for the gross amount of $200,000. Its manufacturing, operating and selling expense, inclusive of the purchase price or value of its timber on December 31, 1908, is $175,000. It has on hand at the end of the year $125,000 in money

but no timber or other assets. Is it possible that Congress istended to tax Company B on an income of $125,000, while Company A is taxed on an income of only $25,000?

Both companies started out with $100,000 assets or capital. Both companies end up with $125,000 in assets. Yet, under the claim of the government, one company's net income has been $125,000, while the other company's net income has been only $25,000.

The Solicitor General, in his application for the Writ of Certiorari, construed the decision of the Court of Appeals as a holding that the *annual appreciation* of timber lands should be taxed as income, and says that it is not only impossible to value such annual appreciation, but that the tax based on such annual appreciation falls upon the very person who should not pay, namely, the person who is endeavoring to develop his trees as a steady income-bearing proposition. Both of the points suggested are answered very conclusively by the situation which exists in the case at bar. In the case at bar no difficulty was found in arriving at the taxable income under the law, and no one has claimed that it is necessary each year to value the annual appreciation of the timber lands. The respondent in the case at bar valued its timber lands as of January 1, 1909, and the valuation it placed upon them was found by the Court to be correct and was in no way questioned by the Government. When timber was sold in 1909, 1910, 1911 and 1912, the resposdent accounted to the Government for the amount received for the timber less the operating expenses and less the value which the timber had on January 1, 1909. The Government therefore received all the tax to which it was entitled upon any appreciation which the timber had from January 1, 1909, up to the date of its sale, and also upon any operating profit which the respondent made from the manufacture

and sale of that timber. The second point raised by the Solicitor General should also give him no concern. It is the position of the Government that the total receipts from the sale of timber are income, so under that view of the case it makes little difference to the taxpayer whether the tax is computed year by year or whether it is computed all together. The Government takes it all in any event, and the injustice which the Solicitor General seeks to avoid is hardly as severe as the one he seeks to impose.

THE MINING CASES.

The Solicitor General referred in his petition to three cases decided by this Court. They are the cases of:

Stratton's Independence v. Howbert, 231 U. S. 399.

Stanton v. Baltic Mining Co., 240 U. S. 103.

Von Baumbach v. Sargent Land Co., 242 U. S. 503.

all of which involve questions concerning the taxable income of mining companies. In none of these cases was the question involved in the case at bar at issue, and in the Sargent Land Co. case this Court expressly so stated.

The Solicitor General has made strenuous efforts to bring the case at bar within the rule of the Stratton's Case, by claiming that the question in the case at bar is whether or not a lumber company manufacturing lumber can, in ascertaining the income which is the measure of its tax under the Corporation Excise Tax Law, deduct from the gross proceeds of the lumber sold the difference between the gross proceeds and the moneys expended in cutting and marketing the lumber, the result of such course being to wipe out all taxable income under the law. As previously shown, this case presents a vastly different question, viz.: Can a lumber manufacturing

company deduct from the gross receipts for the taxing year the cost or the actual definitely ascertained value on January 1, 1909, of the capital assets or raw materials which it has consumed and disposed of during the year. Or to use the concrete illustration already referred to: A lumber company owns timber on January 1, 1909, the actual market value of which is $50,000. It manufactures and sells such timber during the year 1912 for $75,000 net. What is its income from this transaction for the year 1912? Is it $25,000 or it it $75,000?

In the Stratton's case, this Court held on questions certified to it by the Circuit Court of Appeals for the Eighth Circuit, that the proceeds from ore sales are to be treated as income, and a corporation is not entitled to deduct therefrom the value of the ore in place, *if* the definition of the "value of the ore in place" means the gross proceeds of the sales of the ores mined during the year, minus the moneys expended in extracting, mining and marketing the ores, the result being to wipe out all income.

In the case at bar, even if the operation of a timber company could be compared with the operation of a mining company, no such situation is involved. As previously stated, the deduction by Mitchell Bros. Co. from its gross receipts of the value, on January 1, 1909, of the stumpage consumed during the year did not operate to wipe out all of the taxable income of Mitchell Bros. Co. The company accounted to the government for all of the profit derived from the manufacture and sale of its timber, and it also accounted to the government for all the increase in value which accrued after December 31, 1908. Thus for the year 1909, it paid an excise tax on a net income of $26,302.34, or $1.25 per thousand feet; for 1910 a net income of $55,292.16, or about $2.40 per thousand feet; for 1911 a net income of $56,219.27 and for 1912 a

net income of $77,134.84, or about $3.00 per thousand feet for 1911 and 1912 (R. 76-93).

Stanton v. Baltic Mining Co., 240 U. S. 103, arose under the income tax law of 1913, but the decision of this Court seems to have been based on the theory that the tax as it affected mining companies was "not a tax upon property as such because of its ownership, but a true excise levied on the results of the business of carrying on mining operations". The constitutionality of the law as it affected mining companies was sustained, and it was held that the fact that "adequate allowance by way of depreciation" could not be made for exhaustion of the ore body did not make the tax one upon property because of its ownership and therefore subject to apportionment.

In *Von Baumbach v. Sargent Land Company*, 142 U. S. 503, this Court held that the earlier decisions in the Stratton's Independence and Baltic Mining Co. cases were controlling and, applied the rule of those decisions to royalties received by the lessor under certain mining leases.

But there is an inherent and fundamental difference between a lumber manufacturing company and a mining company which makes these mining cases clearly inapplicable to the case at bar. As was said by this Court in the Stratton's Case, "the peculiar character of mining property is sufficiently obvious. Prior to development it may present to the naked eye a mere tract of land with barren surface, and of no practical value except for what may be found beneath. Then follow excavation, discovery, development, extraction of ore, resulting eventually, if the process be thorough, in the complete exhaustion of the mineral contents so far as they are worth removing. Beginning from little, when the existence, character and extent of the ore deposits are prob-

lematical, the value may increase steadily or rapidly so long as discovery and development outrun depletion, and the wiping out of the value by the practical exhaustion of the mine may be deferred for a long term of years".

Lumbering operations are not characterized by any such uncertain and problematical considerations. The stumpage which a company owns at a given date has a known value. It can be sold in the open market at that value. It needs no "excavation, discovery, development or extraction" to ascertain the quantity or quality of the visible and tangible assets. The assets are there, easy of measurement and subject to accurate appraisal and ready sale for their actual, fair market value, and not for a price based upon speculative considerations such as past production, uncertain estimates of the extent of ore bodies, and upon anticipated difficulties in extraction and a hundred and one other considerations which determine the selling price of a mine. Timber stumpage is constantly bought and sold upon precisely the basis used in the case at bar in arriving at the value on January 1, 1909, of Mitchell Bros. stumpage, and there is nothing speculative or problematical about the valuation as in the case of a mine. It is impossible to ascertain at a given date the number of tons of ore which will eventually be extracted from a mine, and the sale or capital value of a mine cannot, therefore, be accurately determined on that basis. So many considerations enter into the value of a mine that it is impossible and contrary to experience to say that because a mine has produced one million tons of ore during a certain year at a value in the mine of one dollar per ton, therefore the value of that mine at the beginning of the year was one million dollars. The value may have been there, as disclosed by the subsequent operations, but, as said by this Court, the value of a mine at a given date is not to be determined "upon the basis of

latent and occult intrinsic values, but upon considerations that affect market value and have their influence upon men of affairs charged with the management of the business and accounting of corporations that are organized for profit and are engaged in business for purposes of profit".

In the case of timber companies, the value of their stumpage at a given date, as determined by an estimate of the number of feet and the market value of standing timber similarly situated, is based absolutely upon "considerations that affect market value and have their influence upon men of affairs charged with the management of the business and accounting of corporations that are organized for profit and are engaged in business for purposes of profit". In the case of a lumber company, there is no question of "latent and occult intrinsic values". The timber which Mitchell Bros. Co. owned on January 1, 1909, was in existence, above the ground, visible to any one who cared to look at it, and the precise quantity of which could be ascertained by any one qualified to appraise standing timber. There is at all times a market for standing timber, and the market value at any particular time is easily ascertained. Standing timber is always sold up on an actual estimate made of the quantity of timber it will cut. There is no difficulty about speculative or unknown values. The value is there on a given date and it can be ascertained with reasonable accuracy and certainty. It is, in actual practice, so ascertained whenever a sale of standing timber is made.

The Solicitor General contends that some of the decisions of this Court above referred to are inconsistent with the decision of the Circuit Court of Appeals in the case at bar. We can see no inconsistency. The Solicitor General says that the Circuit Court of Appeals in its decision hold (contrary to the cases cited) that the test

is not the income received during the taxing year *from* capital, but the nature and value of the capital prior to the time the taxing law went into effect. We do not so understand the decision of the Court of Appeals, and it certainly does not dispose of the case upon any such basis. The Circuit Court of Appeals held that Mitchell Brothers Company had properly paid the excise tax on *all the income which it had received during the taxing year from capital*, and that it need not pay an excise tax on that portion of its *receipts*—not income—which represented capital owned when the taxing law went into effect; that, while the excise tax was measured by the income irrespective of its source, the amount received from the sale of capital assets owned when the taxing law went into effect was income only to the extent that it represented gain or profit accruing and received during the taxing years.

The Solicitor General says also, that "There would have been very little revenue derived from the Corporation Excise Tax of 1909 if all income derived from capital accumulated prior to that year was to be excluded". Under the decision of the Mitchell case, no income derived *from* capital accumulated prior to 1909 was excluded. Mitchell Brothers accounted for and paid a tax on all of the operating profit derived from the manufacture and sale of its timber, and it accounted for and paid a tax on all of the increase in value which accrued subsequent to January 1, 1909. It was and is the contention of the company, and the Circuit Court of Appeals held, that the assets which it had on December 31, 1908, were its capital on that date, and it was only the income *from* that capital which furnished the measure of its tax.

In this holding the Circuit Court of Appeals has done nothing more, as previously shown, than to follow the construction placed upon the Corporation Excise Tax

Law by the governmental department having its administration and execution in charge during the entire life of the statute. No one has asked that income derived *from* capital shall be excluded. We ask only that the capital itself owned prior to January 1, 1909, and disposed of afterward shall not be included, while the gain or profit derived from that capital should be included. And the Solicitor General is very much in error in saying that very little revenue would have been derived from the Corporation Excise Tax Law if all assets accumulated prior to January 1, 1909, were to be considered as capital at their then value. As a matter of fact, the government collected about $100,000,000 in taxes under the excise tax law, and every dollar of that $100,000,000 was levied and collected by the Internal Revenue Department on the precise basis underlying the decision of the Court of Appeals in the case at bar.

MEANING OF TERMS "CAPITAL AND "INCOME".

The Solicitor General claims that the opinion of the Court of Appeals shows a confusion as to the true legal meaning of "capital" as distinguished from "income", which must be exceedingly burdensome to the public and the government in the execution of the taxing laws. The opinion of the Court of Appeals does not present any confusion to us and the case at bar clearly demonstrates that the difficulties feared by the Solicitor General have not been and will not be encountered.

The Court of Appeals holds that property owned on December 31, 1908, is capital at its then fair market value, and that in case of a sale during a subsequent taxing year the amount realized less the value on December 31, 1908, is income, while the remainder is a conversion of capital and not part of the income. Precisely the same rule has been applied to the merchant used by the Solici-

tor General as an illustration. If he had a stock of goods on hand on December 31, 1908, that stock was his capital. When he sold it, the government in no case asked him to account for the total receipts as income—the government asked him to account only for the difference between his total receipts and the value of his stock on December 31, 1908. It was only this difference which represented income received within the year. (Treas. Dec. No. 1588. See Appendix.)

Where a tax law makes the "income" the measure of the tax, such property as a man possesses at the date of the first incidence of the tax is his "principal" or "capital" or "assets". So far as the tax is concerned, it matters not how or when the citizen acquired that property, whether by purchase, gift or inheritance. Measured in money, the citizen's "principal", "capital" or "asset" is its actual fair market value, i. e., what it will bring in open market.

Any other contention reduces to an absurdity. One may manufacture an article. Its making may cost less than it will bring in open market. Is its real value as an "asset", "principal" or "capital" increased or diminished thereby? Manifestly not.

One may purchase property. If it is the handiwork of man, it will certainly depreciate in value. If it is part of nature, as land, it is likely to appreciate. But as property at any given date it is worth what it will bring in open market.

One may accept a gift. It costs us nothing. If cost is the measure, then if we sell it the whole sum received is income, if the governmest's contention is correct.

One may inherit property, the same is true.

There is but one fair, just and universal rule. What a man owns at any given date is his "principal", "capital" or "assets". Measured in money it is the fair market value of what he owns.

THE ENGLISH CASES.

The English cases of *Coltness Iron Co. v. Black* (1881), 6 App. Cas. 315, and *Kauri Timber Co. v. Commissioner of Taxes* (1903), App. Cas. 771, cited below by counsel for the Government as sustaining his contention, are clearly not in point and of little if any value in construing our law, because they are based upon the peculiar and vastly different language and provisions of the English tax laws.

Coltness Iron Co. v. Black arose under Chapter 6 of 5 and 6 Victoria, which imposed a tax, not upon income or a tax measured by income, but *upon the value of mining properties*, such value to be estimated at the full amount for one year, or the average amount for one year, "*of the profits received therefrom*" within a certain time limited in the act. Certain rules were prescribed for ascertaining the "*profits received therefrom*" and among these rules was one providing in part that:

> "In estimating the balance of profits and gains chargeable under schedule D, or for the purpose of assessing the duty thereon, no sum shall be set against or deducted from such profits or gains * * * on account of loss not connected with or arising out of such trade, manufacture, adventure, or concern; nor *on account of any capital withdrawn therefrom;* nor for any sum employed or intended to be employed as capital in such trade, manufacture, adventure or concern".

The case of *Kauri Timber Co. v. Commissioner of Taxes* arose under the land and income assessment act of 1908 (No. 95 of the Consolidated Statutes of New Zealand), ss., 71, 79, and 87, which provided for a tax upon income derived from business, employment or emolument. The act provided that:

> "In ascertaining the income derived from business, employment or emolument, no deduction shall be made in respect to any of the following items:

• • • (c) *Investment of capital; expenditure of capital; loss of capital; capital withdrawn*".

It will be seen that a mere statement of the statutory provisions involved in these cases makes them wholly inapplicable to the provisions of the excise tax law.

(2) EVEN IF THE TIMBER STUMPAGE VALUED AS OF DECEMBER 31, 1908, COULD BE CONSIDERED AS PART OF THE GROSS AMOUNT OF THE INCOME, IT WAS NOT "RECEIVED WITHIN THE TAXING YEARS.

Even if the value which the company's stumpage had on December 31, 1908, is "income" within the meaning of the law, it was not income "received" during any of the years 1909, 1910, 1911 and 1912. It came into the taxpayers' possession and became the proeprty of the taxpayer prior to January 1, 1909, and it is therefore not taxable under the law.

It is true that during the years named the property in question was converted from realty into personalty. It changed form. From realty it became part cash, part lumber in the yards and part credits on the books of the taxpayers. Originally it was property in the possession of the taxpayer. It is still the same in different form. So far as any income over the capital value of the stumpage cut has been gained by manufacture, the tax on that income has been paid.

Under such circumstances, how can it be claimed that the unearned increment which accrued prior to December 31, 1908, is "income • • • received • • • during such year", i. e., in 1909, 1910, 1911, 1912?

The war income tax construed in *Gray v. Darlington* was broader in its terms (heretofore quoted) than the act of August 5, 1909, in question. Yet in Gray v. Darlington increase of value over a period of four years was held untaxable at all as income for any particular year,

though the increase was actually received in cash during the year for which the tax was sought to be levied. The war income tax act and that of 1909 are alike in that in both the limit is *income received during the year* for which the tax is levied.

A similar principle was enunciated in *Reynolds v. Williams*, Fed. Cases No. 11734. In that case it appeared that in 1863 the L. & I. Railroad Co. had $100,000 of U. S. bonds as an investment of accumulated undivided surplus. In 1867 the company went out of business and transferred the bonds to a trustee, presumably for its stockholders. The trustee was assessed five per cent income tax on that $100,000 as "gains, profits and income" received during 1867. The Court held that the $100,000 being originally held by the company as trustee for its stockholders, and now by another trustee for the same stockholders, the mere change of legal title from one trustee to another did not make the $100,000 taxable as income for 1867. In effect the Court held that the fund having been accumulated prior to the year for which the tax was levied, for the benefit of certain parties, it was not taxable as their income "received" during a later year.

The word "receive" means to take, get or obtain. See Encyclopedia Dictionary. It is frequently used in the sense of "acquire". See—

Early v. Friend, 16 Gratt. 21.
West v. Weyer, 46 O. St. 66.

It is also sometimes used as synonymous with "vest in".

Thompson v. Marshall, 73 Conn. 89.

In *Scottish Provident Insurance*, 1912 Session Cases 452 (Scotch), the question was whether certain interest money claimed to be taxable under the English Income

Tax Law was "*received in Great Britain* in the current year".

The Lord President said:

> "I use the word 'received' because you may quite well have a profit which has not been paid to you in hard cash. Many partnerships do not pay profits in hard cash, or a partner does not take his profits in cash, but nevertheless the profits are earned, and being earned they are necessarily received by the partners at the time they are earned".

In all these senses the taxpayers were the absolute owners in possession of this increment prior to December 31, 1908.

> "There is a presumption against retrospective operation, and we have said that words in a statute ought not to have such operation 'unless they are so clear, strong and imperative that no other meaning can be annexed to them, or unless the intention of the legislator cannot be otherwise satisfied'."
>
> United States v. Am. Sugar Co., 202 U. S. 577.
>
> United States v. Brown, 159 U. S. 78.

B.

EVEN IF THE AMOUNT RECEIVED FOR THE STUMPAGE COULD ALL BE CONSIDERED INCOME, THE VALUE WHICH THE STUMPAGE HAD ON JANUARY 1, 1909, WAS PART OF THE MANUFACTURING COST OF THE LUMBER AND DEDUCTIBLE AS SUCH.

Mitchell Brothers Company owns all of the timber lands from which it cuts its timber and manufactures its lumber and other products. The supply of timber being limited, the company cannot, in the nature of things, go into the market and buy timber to take the place of that which is consumed. The market value of the timber it owns and consumes is, however, the manufacturing cost of that timber as far as determining the profit or income derived from its business is concerned.

To use an illustration applicable to the precise situation existing in the case at bar: Company A buys its logs in the open market at $4.25 per thousand feet—the same as the average value on December 31, 1908, of Mitchell Bros. Company's consumed stumpage as found by the court—manufactures the same into lumber and sells it for cash or on credit. The cost of the logs it has paid out to the seller as part of its expense of operation—an integral element in the expense of producing its manufactured product—it is entitled to deduct from "the gross amount of the income of such corporation * * * received within the year". In this it differs not a whit from any merchandising corporation which buys goods at wholesale and sells at retail. The law and the department regulations allow and provide for such deduction. It therefore paid no excise tax on the amount expended in the purchase of logs. Now Mitchell Bros. Company differs from Company A only in the fact that it *owned* logs of the same market value as those Company A *purchased*. It treated those logs in the same way, sold the lumber at the same figure and received the same amount, but owing solely to its ownership, it is to be compelled to pay excise tax on the full value of its consumed stumpage, while Company A pays nothing on the same value. Sustaining such a contention would put out of business every lumber manufacturing company which owned stumpage. And it would discriminate unjustly and without reason against such companies on account of their ownership of *stumpage* instead of its *cash equivalent*. The market value of the timber which such companies own is precisely what that timber *costs* them, when they manufacture the timber, as part of the manufacturing cost.

Mitchell v. Insurance Co., 92 Mich. 594.

The Solicitor General's contention seems to be that all of the receipts of a business are income, and that nothing can be deducted for the purchase or value of raw materials. So that if a merchant owns at the beginning of the year or purchases the first of the year a stock of goods for $100,000, sells such stock for $90,000 gross and pays out $10,000 as selling expense, his total taxable income for the year has been $80,000. This may be fine for the government, but it is not prosperous business for the taxpayer to be compelled to pay an income tax on $80,000 when he has had no income at all and has lost $20,000 of his capital besides.

But the Solicitor General may say that the merchant can charge against his gross receipts the cost of his raw materials. If a merchant can do so then a company buying, manufacturing and selling timber can surely do the same. Lumber surely is no different than sugar, coffee or dry goods so far as the taxation of income derived from these commodities is concerned. If a company buying, manufacturing and selling timber can charge back against gross receipts the cost of the timber in ascertaining its income, why can not a company which owns its timber at the time the law went into effect charge back against gross receipts the value which that timber had at that time. As far as figuring gain, profit or income for the taxing year is concerned, the situation is precisely the same.

Had Mitchell Brothers in each of the years 1909, 1910, 1911 and 1912 purchased timber stumpage in the open market sufficient to equal in value the amount consumed, there could have been little question of its right to charge into the manufacturing cost the quantity of timber consumed. It did not and could not purchase timber to replace that which was consumed, but the amount consumed did none the less enter into the manufacturing cost at its fair market value. And that fair

market value was the cost of the raw material for the year 1909, 1910, 1911 or 1912, and should be deducted by the taxpaying corporation in the ascertainment of its net income.

To hold otherwise is to discriminate unjustly and arbitrarily against the taxpayer who is unable to buy additional timber in place of that which has been consumed. To illustrate this situation is also to establish its absurdity.

Company A owns or purchases $100,000 worth of timber on December 31, 1908. It manufactures its timber during the year 1909, and sells its product for the gross sum of $200,000. It purchases during the year $100,000 worth of timber to take the place of that which has been consumed. Its operating and selling expense is $75,000. Its inventory at the end of the year shows assets:

Timber	$100,000
Cash	25,000
Total	$125,000

The company's profits have been clearly $25,000, and its taxable income under the law is just as clearly that amount.

Company B, like Company A, owns or purchases $100,000 worth of timber on December 31, 1908. Like Company A, it manufactures its timber during the year 1909, and sells its products for the gross sum of $200,000. It is unable to purchase additional timber to take the place of that which is consumed. Its operating and selling expense is $75,000. Its inventory at the end of the year shows assets:

Timber	None
Cash	$125,000
Total	$125,000

Can it be said that the taxable income of Company B under the law is $125,000, while that of Company A is only $25,000? *It cannot be so said, without making the law operative with glaring inequality and with palpable injustice;* and the contention made by the Government should not, therefore, be sustained. It is well settled that courts will always avoid a construction leading to such a result, where any other and more equitable and reasonable interpretation is present in the statute.

Knowlton v. Moore, 178 U. S. 41, 77, and numerous cases therein cited.

And, as was well said by the Court in United States v. Kirby, 7 Wall. 482, 486, "All laws should receive a sensible construction. General terms should be so limited in their application as not to lead to injustice, oppression, or an absurd consequence".

III.

WHEN THE GOVERNMENT EXACTS A TAX FROM THE CITIZEN, IT MUST BRING ITSELF CLEARLY WITHIN THE LAW.

While the constitutional inhibition that "all duties, imposts and excises shall be uniform throughout the United States", exacts only a geographical uniformity (Brushaber v. Union Pacific Railroad Co., 240 U. S. 1), it is equally true that, as stated by Mr. Justice Field in *Pollock v. Farmers Loan & Trust Co.*, 157 U. S. 595, "If there were any doubt as to the intention of the State to make a grant of the right to impose indirect taxes, subject to the condition that such taxes shall be in all respects *uniform and impartial*, that doubt shall be resolved in the interest of justice in favor of the taxpayers".

And aside from the provisions of our constitution, it is a fundamental principle of taxation under a system of government like ours that taxes shall, as far as possible,

operate equally and uniformly. The rule is well stated by Mr. Gray in his standard work on the "Limitations of Taxing Power", in the following language:

> "The spirit of equality which pervades the constitutional law of taxation may be invoked as a guide to the interpretation of laws and constitutional provisions * * * The doctrine of proportionate equality in taxation has been received by American students of constitutional law so that in cases involving interpretation of tax laws, *the idea of equality is constantly present; and that construction is favored* which tends toward equality".

In this connection, we may also call the attention of the Court to the well established principle that the imposition of a tax by a government is a burden upon private interests laid upon private property under the necessary exercise of an arbitrary power, and because of the character of the power exercised, the rule is universal that when the question arises whether given property should be held subject to the tax, the taxing power must make it clear that the statute was intended to cover the property in question.

> Gill v. Bartlett (C. C. A. 1st Cir.), 224 Fed. 927, 928.

The rule has been clearly and explicitly laid down by this Court in *Spreckles Sugar Co. v. McClain*, 192 U. S. 397, 416, wherein the Court, speaking through Mr. Justice Harlan, quoted with approval the following language:

> "It is the well settled rule that the citizen is exempt from taxation, unless the same is imposed by clear and unequivocal language, and that, *where the construction of a tax is doubtful, the doubt is to be resolved in favor of those upon whom the tax is sought to be laid*".

And in the recent case of *Gould v. Gould* (Nov. 19, 1917; U. S. Advance Opinions 1917, p. 65) this Court said:

> "In the interpretation of statutes levying taxes it is the established rule not to extend their provisions, by implication, beyond the clear import of the language used, or to enlarge their operation so as to embrace matters not specifically pointed out. In case of doubt they are construed must strongly against the Government, and in favor of the citizen".

To the same effect see:

Swan & Finch Co v. United States, 190 U. S. 143, 146.

Benziger v. United States, 192 U. S. 38, 55.

Eidman v. Martinez, 184 U. S. 578.

American Net & Twine Co. v. Worthingham, 141 U. S. 468, 474.

Hartranft v. Wiegmann, 121 U. S. 609, 616.

United States v. Isham, 17 Wall. (84 U. S.) 504.

Equitable Trust Co. v. Selden, Fed. Cas. No. 4508 (Affirmed 94 U. S. 419).

Shallus v. United States, 162 Fed. 653, 656.

Hayes & Co. v. United States, 150 Fed. 63, 66.

United States v. Fish Co., 146 Fed. 104, 106.

Voight v. Miholovitch, 125 Fed. 78, 83.

Hempstead v. Thomas, 122 Fed. 539.

Commercial Bank v. Sandford, 103 Fed. 98, 100.

Southern R. R. v. North Carolina Corp. Com., 97 Fed. 513, 518.

United States v. Merck, 91 Fed. 639, 640.

In re Southern Pacific R. R. Co., 82 Fed. 311, 313.

Mathewson v. United States, 71 Fed. 394, 395.

In re Wetherell, 60 Fed. 267, 270.

Rice v. United States, 53 Fed. 910, 912.

Penn. Co. v. McClain, 105 Fed. 367, 370.

In *U. S. v. Isham*, 17 Wall (84 U. S. 504), the Court said:

> "If there is a doubt as to the liability of an instrument for taxation, the construction is in favor of the exemption, because, a tax cannot be imposed without clear and express words for that purpose".

What was said by the Court in Pennsylvania Co. v. McClain, 105 Fed. 367, 370, could be said with equal truth and with equal force in this case:

> "Enough has been said to show that while the exact meaning of the statute is not free from perplexity (to use the language of Mr. Justice White in Knowlton v. Moore, 178 U. S. 41), it is only after resolving every doubt in favor of the government that the sense intended for can be read into the act; and even then the construction is strained and unnatural. This being so, I think the government's contention should not prevail, upon the well understood principle of taxation—that a doubtful tax does not exist. Before the property of a citizen can be taken under the exercise of a taxing power, it is necessary that the statute be clear and unambiguous, so there may be no doubt about the intention of the state to take the property of the citizen for public purposes. As I have attempted to show and as I think must be conceded, the section under consideration certainly cannot be said to express clearly the meaning for which the government argues, while the opposite construction seems to give a much more natural and reasonable meaning to the words".

In *Swan & Finch Co. v. United States*, 190 U. S. 143, 146, the Court, in holding that an exporter was not entitled to a certain exemption, gave among its reasons:

> "Third. *The uniform construction placed by the department charged with the execution of the statute has been against it.*
>
> Fourth. Being a governmental grant of a privilege or benefit, it is to be construed in favor of the government and against the party claiming the grant. Where the burden is placed upon a citizen, if there be a doubt as to the extent of the burden, it

is resolved in favor of the citizen, but where a privilege is granted, any doubt is resolved in favor of the government. In Hartranft v. Wiegmann, 121 U. S. 609, 619, the one rule was thus stated: 'We are of opinion that the decision of the Circuit Court was correct. *But if the question were one of doubt, the doubt would be resolved in favor of the importer, as duties are never imposed on the citizen upon vague or doubtful interpretation'.*" Citing numerous cases.

The Corporation Excise Tax Law of August 5, 1909, is no exception to the rule thus laid down. The courts have held that the excise tax law should be strictly construed; and that all reasonable doubts in respect thereto should be resolved against the government and in favor of the citizen.

Pa. Steel Co. v. Railway Co. (C. C. A. 2nd Cir.), 198 Fed. 774, 775.

Mutual Benefit Life Ins. Co. v. Harold, 198 Fed. 199 (Judgment affirmed 201 Fed. 918).

Building & Loan Assn. v. Harold, 203 Fed. 876.

And in the case at bar, as in the case of Swan & Finch Co. v. United States above referred to, the *uniform construction placed upon it by the governmental department charged with the execution of the statute has been against the contention now made by the United States.* In view of that uniform construction, which was always and consistently to the effect that the statute did not seek to tax receipts derived from capital; and in view of the further fact that when the statute is viewed in its most favorable light for the government, it must be held that there is indeed grave doubt that the language of the law is sufficiently comprehensive to include receipts derived from the sale or conversion of capital assets, it must necessarily follow that the contention of the government cannot be sustained.

To sustain it would be to resolve every doubt in favor of the government and against the taxpayer.

IV.

THE VALUE OF THE COMPANY'S STUMPAGE ON DECEMBER 31, 1908, IS A QUESTION OF FACT TO BE DETERMINED FROM EVIDENCE, AND NOT FROM ARBITRARY FIGURES USED IN THE COMPANY'S BOOKKEEPING.

The Commissioner of Internal Revenue, in making the reassessment herein involved, permitted the company to deduct from receipts, on account of timber stumpage cut and converted, such stumpage at a value of $2.25 per thousand for hardwood and hemlock, and $8.00 per thousand for pine. These figures of $2.25 and $8.00, as hereinbefore shown, had been used by the company in its bookkeeping since the organization of the corporation in 1903. At the end of each year, there was transferred from the timber land account into the lumber account the timber which had been cut and manufactured into lumber during the year, and there was transferred into a stump land account the lands which had been cut over during the year. This transfer was made by crediting the timber land account with all hardwood and hemlock timber cut at the rate of $2.25 per thousand, and with all pine timber cut at the rate of $8.00 per thousand, and with all lands cut over at the rate of $2 per acre; and by making a corresponding charge of the same items to the timber and stump land accounts respectively. It was estimated at that time that, by using these figures of $2.25 and $8.00 per thousand for stumpage, and $2.00 per acre for stump lands, the timber land account would just about be wiped out when all the timber was removed. On account of closer cutting in later years, and on account of improved methods and utilization of by-products originally deemed worthless, this proved untrue, but the company neverthe-

less continued to use the same figures in its bookkeeping down to the present time. These figures, however, have not been considered as in any way indicative of the actual market value of the company's timber during recent years, and the figures have been used for purposes of bookkeeping only (R. p. 162).

After the passage of the Corporation Excise Tax Law of August 5, 1909, and preparatory to making its returns of income under that law, the officers of the company determined what was in their opinion the fair market value on December 31, 1908, of the timber stumpage owned by the company on that date. Valuations per thousand, log scale, were placed on the different kinds of timber on the basis of what the stumpage would have sold for in open market on December 31, 1908. The District Court found that the valuations thus fixed were not excessive, and that the fair market value of the timber stumpage of the company on December 31, 1908, was actually equal to such valuation (R. p. 104, 105). Counsel for the Government did not question this finding.

The Commissioner, in making his reassessment, based it upon the difference between the actual value of the stumpage on December 31, 1908, and the value of such stumpage as determined by the book entries of $2.25 and $8.00. That is, instead of permitting the company to deduct the market value of the stumpage on December 31, 1908, the commissioner permitted it to deduct only the value as determined by these book entries.

It is the contention of the Government that the value of the company's stumpage must be conclusively presumed to be as determined by the book entries of $2.25 and $8.00, notwithstanding the fact that such book entries were not used and were not considered in recent years as in any way indicative of the actual value of the company's timber stumpage, and notwithstanding the finding

of the Court (not questioned by the government) that on December 31, 1908, the stumpage was actually of the value claimed by the company and used by it in its returns. This contention of the Government is supported by no citation of authorities, and as a matter of fact, it is contrary to all of the cases which have arisen under the excise tax law as well as to other cases involving general principles of law governing such matters.

Baldwin Locomotive Wks. v. McCoach, 215 Fed. 967 (Affirmed C. C. A. 3rd Cir., 221 Fed. 60).

Sargent Land Co. v. Von Baumbach, 207 Fed. 432 (Affirmed C. C. A. 8th Cir., 219 Fed. 31).

Industrial Trust Co. v. Walsh, 222 Fed. 437.

United States v. Nipissing Mines Co., 202 Fed. 803 (Modified and affirmed on other grounds, 206 Fed. 431).

Forty Fort Coal Co. v. Kirkendall, 233 Fed. 704.

United States v. Guggenheim Exploration Co., 238 Fed. 231, 236.

United States v. Railroad Co., 17 Fed. 719.

Leather Nat'l Bank v. Treat, 128 Fed. 262, 62 C. C. A. 644.

Marquette, Etc., R. R. Co. v. United States, 123 U. S. 722.

Railroad Co. v. United States, 110 U. S. 205, 208.

Greshan Life Assurance Society v. Bishop, 71 L. J. K. B. 618 (1902) 1 A. C. 287; 86 L. T. 693; 50 W. R. 593; 66 J. P. 755.

Forbes v. Scottish Provident Assn., 33 Scottish Law Rep. 228.

Crookston Bros. v. Inland Revenue, Sessions Cas. (1911), 217.

Assets Co. v. Inland Revenue, 24 Sessions Cas. 5; 24 R. 578.

Bailey v. Railroad Company, 106 U. S. 109.

Chicago & N. W. R. R. Co. v. Auditor General, 53 Mich. 79, 85, 86.

In determining questions of taxation, valuations made by the taxpayer are never regarded as conclusive against the state. If they were it would open the door to endless frauds on the public revenue. If not conclusive on the state, why should they be so on the taxpayer? Estoppels must be mutual. No fraud has been perpetrated or attempted by the plaintiff in the case at bar. The state should have no object to attain except justice. That is the main end for the existence of government.

Chicago & Northwestern Ry. Co. v. Auditor General, 53 Mich. 79.

In this case, the Supreme Court of Michigan, speaking through Judge Cooley, an eminent authority on taxation, said:

"The answer made on behalf of the state to this objection is that the complainant in keeping its accounts and making its reports has not discriminated between the gross receipts from the business done on the consolidated roads and that done on the other roads which it has operated, and for that reason it was proper for the state authorities to treat all the roads as one, and to hold the complainant estopped from disputing the propriety and legality of an assessment based upon the report so made. This answer has plausibility, but we do not conceive it to be conclusive or sound.

It sometimes becomes an act of simple justice in the law to hold a party to the truth of something he has asserted, and not to suffer him to aver or prove the contrary, because to do so would be to mislead and prejudice some other party who has acted in reliance upon the truth of his assertion. The rule under which this is done is a simple rule of justice: *Maxwell v. Bay City Bridge Co.*, 41 Mich. 453; *De Mill & Moffat*, 49 Mich. 125; and the cases must be rare in which it can be applied in behalf of the State against its citizens, when it is seeking to collect its revenues, unless the citizen is attempting some fraud

upon the law, or some evasion of its provisions. What the state aims at in its revenue laws is to take from each of the persons liable the just proportion which he ought to contribute to the public burdens; and it is neither justice nor sound public policy to seize upon advantages — if any should offer — to make any one pay more than the just share which a proper construction of statutes framed to insure equality would require of him. If a mistake has been made which would give the opportunity for such advantages, the State is interested rather in correcting it than in working out results not intended by the law through the means of it".

In *Baldwin Locomotive Works v. McCoach*, 215 Fed. 967, a case arising under the excise tax laws, it was held that an increase of the book value of the assets of a corporation does not constitute any part of the gross amount of its income received within the year; that the books are not conclusive, either for or against the corporation or the Government.

Is affirming the decision of the District Court for the Eastern District of Pennsylvania, the Circuit Court of Appeals for the 3rd Circuit said in part (221 Fed. 60):

> "We agree with the District Court that this increase of valuation was not income within the meaning of the statute. Nothing whatever was added to the corporate property, which remained exactly the same after the appraisement as before. The only thing done was to put upon the company's books an expression of expert opinion that certain property was worth a certain sum, and this can hardly be said to be income, or even gain in any proper sense. The company could not become either richer or poorer by making a few book entries that merely recorded a new estimate of how much it was worth".

In *Sargent Land Co. v. Von Baumbach*, 207 Fed. 432, the District Court for the District of Minnesota said on the question of the conclusiveness of the books of the company:

"I attach no importance to the fact that the company used the word 'dividends' in making this distribution. If the money was not gross income, the fact that when they distributed it they called it dividends could not in any sense change the law as to what the real character of the money was. Nor do I attach any importance to the fact that upon the books the company carried no 'depreciation' account".

In *Industrial Trust Co. v. Walsh*, 222 Fed. 437, it was held that a net increase in the book value of securities held by a banking and trust company as an investment for surplus funds, as shown by an adjustment of such values entered on its books, such increase in some instances extending over a number of years, does not constitute "net income" received by the corporation during the year in which the adjustment was made, within the meaning of the Corporation Excise Tax Law.

In *United States v. Nipissing Mines Co.*, 202 Fed. 803, it was claimed on behalf of the Government that charges for depreciation could not be deducted from income because not taken account of on the books of the company. The Court held that the books were not conclusive, saying on this point:

"The suggestion that there can be no allowance for depreciation, unless such depreciation is entered in the books of the company, recorded from time to time, seems to me without force. The books may be very badly kept, kept in such a way as will in the end bring them into trouble and difficulty; but this act does not provide any penalty for bad bookkeeping. It simply provides that one per cent of the net profits of the various corporations shall be turned over to the Government, and provides that in finding out that net profit, there shall be a reasonable allowance for depreciation".

In *Bailey v. Railroad Company* (1882), 106 U. S. 109, the railroad company had issued certain dividends in

scrip, with a recital that the company "has hitherto expended of its earnings for the purpose of construction, etc., moneys equal to 80% of the capital stock of the company". The Court held that the dividends in scrip were taxable under the act of June 30, 1864, as amended, but that the company could show what were its earnings from September 1, 1862, to December 19, 1868, when the income tax law was in force, as its earnings during any other period were not subject to the tax. In disposing of the question, the Court says in part:

> "It was quite legitimate for the assessor to treat this as evidence of an amount of earnings which had never been taxed, and make the assessment accordingly. It was equally legitimate for the Secretary of the Treasury, upon proof that the accumulation had been going on from the organization of the company, in 1853, to apportion the amount in equal proportions for each year, and to deduct nine-fifteenths thereof for the years which had elapsed before the taking effect of the act taxing incomes. And it is entirely consistent with the declaration itself to show in point of fact what was the amount of earnings accrued during the period while the income tax act was in force which had not been assessed for taxation as profits carried to constructions or other account. The declaration in the certificates could not be conclusive of anything not inconsistent with it, for an estoppel only prohibits contrary allegations. The proof admitted on the trial below did not contradict the certificates, but only served to rebut a presumption, which, as matter of law, was not conclusive. Its tendency and effect were to exact from the company the full tax upon every dollar of its earnings, which had not previously paid its proper assessment, and which, in any form, was subject to taxation, and to relieve it only to the extent to which otherwise it would have been subjected to the payment of a second tax upon the same fund. This result, and the process by which it was reached, seem to us strictly to conform both to the letter and spirit of the law governing the subject".

In *United States vs. Railroad Co.*, 17 Fed. 719 (1883), a question arose on the construction of Act of July 14, 1870 (16 Stat. 260), providing for a tax on "all undivided profits of such corporation which shall have accrued and been earned and added to any surplus, contingent or other fund". Certain funds were used by the railroad company out of its earnings in construction work, and they were carried to an account on its books called "expended earnings". It was held the funds as expended were taxable under the act though not "added to a fund as a matter of bookkeeping". The Court (Circuit Court, Western Dist. of Mich.) said on this point:

> "In bookkeeping, and within the meaning of the act of 1870, net earnings or undivided profits are added to a particular fund by proper transfer entries in the books of account. But the object of the statute is not defeated if profits used for construction are not carried into the proper account on the books; for, within the meaning of the statute, and according to common understanding and experience, they must be considered as added to construction fund, if they are used for construction".

In *Marquette, Etc., Railroad Co. v. United States*, 123 U. S. 722, the Supreme Court of the United States, in construing a clause of the Internal Revenue Act of July 14, 1870, said as to the ascertainment of the meaning of the Act of Congress:

> "This is to be ascertained not by inquiry into the manner of keeping railroad accounts, but by interpreting the language used by Congress at different times to give expression to its will; not by determining whether as a matter of bookkeeping it is usual to carry undivided profits used for construction to a construction fund, but by studying the several statutes to see if it was intended that, if so used, they should be taxed under the act of 1870".

See also—

Railroad Co. v. United States, 110 U. S. 205, 208.
Leather Nat. Bank v. Treat, 128 Fed. 262, 62 C. C. A. 644.

Under the English Income Tax Law imposing a tax on interest on investment made in foreign countries, where such interest was "received" in the United Kingdom, it was held that the mere fact that such interest was credited and taken into account on the books of the company in the United Kingdom was not equivalent to its receipt so as to subject it to the tax.

Gresham Life Assurance Society v. Bishop, 71 L. J. K. B. 618 (1902); A. C. 287; 86 L. T. 693; 50 W. R. 593; 66 J. P. 755.

When this case was before the Court of Appeals (1901), 1 K. B. 153; 70 L. K. B. 298), it was held that crediting this interest on the books of the company in the United Kingdom was equivalent to its receipt there, the Master of the Rolls saying in his opinion:

> "The fact, in this case, is that the society has received dividends, though not in specie on foreign securities from their agents in foreign parts. These dividends so received they have brought into account in making up their profit and loss account * * * It seems to me that the irresistible inference to be drawn from the facts stated is that the society have received these dividends on foreign securities in account, they have dealt with them as received in account, and they have distributed them as having been received in account, and they cannot say that they have not received them in the United Kingdom when the Crown claims income tax on them".

This decision was reversed by the House of Lords. In the various opinions reversing the decision are the following statements:

Lord Halsbury: "I do not think any amount of book-

keeping or treatment of these assets, wherever they may be, will be equivalent to or the same thing as receiving the amount in this country".

Lord Brampton, alluding to the ruling of the Master of the Rolls in the court below, referred to the accounts of the taxpayer and said:

> "Those accounts were framed partly to satisfy the requirements of the Life Assurance Companies Act * * * and partly in obedience to articles 77 and 78 of the society's deed of settlement, directing books to be kept in which full entries shall be made of all matters which shall properly be the subject of debit or credit account, so that the financial state of the company may at all times appear as accurately as circumstances will permit; * * * The accounts before your Lordships profess to do no more than this, and no inference of fact can be drawn from them other than or in addition to those stated in them. In my opinion, there is total absence of any evidence to justify a finding that the interest in question has ever been received in the United Kingdom".

To the same effect see:

Forbes v. Scottish Provident Assn., 33 Scottish Law Reports 228.

Crookston Bros. v. Inland Revenue Sessions Cases (1911), 217.

Assets v. Inland Revenue, 24 Sessions Cas. 5, 24 R. 578.

In *Forbes v. Scottish Provident Association*, supra, it was said:

> "Every man and every company having foreign or colonial investments, of course, knows of the interest arising from them, takes note of it, and extends it in any statement of affairs which is required to be made up. But this will not make the interest 'received' in the United Kingdom".

In *Assets Company v. Inland Revenue, supra,* a tax was sought to be imposed on profits or gains made by the Assets Company on sales of investments, such investments having been inventoried on the books of the company at certain values. The question being on what had been paid for these investments in order to determine what the profit was on their sale, it was held that the valuations on the books was not evidence of what the investments had actually cost upon which to base an assessment for profits against the company. The Court said in part:

> "I am of the opinion that the case presented to us does not contain materials to enable us to decide whether, during the year to the fifth of April, 1895, two preceding years, profits or gains were made by the Assets Company on the realization of assets or investments. The date on which we are asked to hold that profits or gains were earned during those years are, I understand, the sums realized on the sale of investments as compared with the value at which the assets realized stood in the books of the liquidators of the City of Glasgow Bank when taken over by the Assets Company. Now, I do not think that we can take these book values as truly representing the price paid for the assets or investments".

Valuations for purposes of taxation are always based upon the actual value of the property at the time of the assessment. This means not its cost to the owner, or its price at sacrifice sale, but the price it would bring at fair private sale between parties dealing on equal terms.

37 Cyc. 1011.
Walker v. People, 192 Ill. 106.
Winnipeseogo Lake v. Gilford, 67 N. H. 514.
Central Rd. v. State Board, 49 N. J. L. 1.
People v. Barker, 39 N. Y. Supp. 776.

Value is a question of fact, not of account keeping. This is elementary.

3 Wigmore on Evidence, 1943.
Harvey v. United States, 113 U. S. 243.
The Colon, Federal Cases, 3025.
The Kate Irving, 5 Fed. 630.
Bank v. Jones, 21 Wall. 325.
Nelson v. Bank, 69 Fed. 798.
United States v. Nipissing Mines Co., 202 Fed. 803.
Gray v. Darlington, 15 Wall. 66.

In the latter case the Court said:

> "The actual advance in the value of property over its cost may in fact reach its height just before its sale. The value of the property may in truth be less at the time of the sale than at any previous period in ten years".

Books of account are evidence against the taxpayer who made the entry, but unless there be an estoppel they are in no way conclusive. Books of account before they can be received in evidence must be shown to be correct.

Darlington v. Atlantic Trust Co., 68 Fed. 849.
The Norma, 68 Fed. 509.
Little Granite Rock v. Dallas, 66 Fed. 522.
Owens v. Adams, Fed. Cas. 10633.
American Surety Co. v. Pauley, 72 Fed. 470.

And may be discredited.

Bank v. Rawls, 7 Ga. 191.
Barber v. Bull, 7 Watts & S. 391.
Hampton v. Michael, 6 Gratt. 151.

It is held that even sworn statements of taxable property required to be furnished to assessing officers, are

not conclusive upon the taxpayer, and are subject to explanation and correction by him.

Brown v. French, 80 Fed. 166.
R. R. Co. v. Auditor General, 53 Mich. 79.
State v. Ricaud, 90 Fed. 214.
Troy v. Fall River, 167 Mass. 517.
Dunnell Mfg. Co. v. Pawtucket, 7 Gray 277.

There is no claim in this case that Mitchell Bros. Co. attempted to conceal anything, or that its officers did not base the income returns on the books of the company. The fiscal year of the company ran from October 1st to September 30th, and its books were therefore kept accordingly. In making up its income returns for the various years, the accounts on the books were readjusted so as to show the gains for the *calendar* year instead of the company's *fiscal* year. There has been and there is no claim that in making its income returns for the various years all of the receipts and all of the gains of the company were not accounted for. They were all accounted for, and they were taken from its books. When it came to the question of deducting a proper amount for restoration of capital or for depletion of assets, that amount could not be taken from the books because the books since 1903 had never been readjusted to show the increase in value of the company's timber properties. The figures of $2.25 and $8.00 per thousand for stumpage and $2.00 per acre for stump lands had never been changed since the organization of the company, yet they had never in recent years been considered as indicating the actual value of the timber lands. When it became necessary, therefore, to make up its income returns, the officers of the company took the only reasonable, fair and just way of arriving at the amount to be charged against receipts for capital assets converted and sold. They determined what the value of such assets was on December 31, 1908,

and the Court has found that the value fixed by them was actual. This finding the Government does not question.

In view of these facts, the contention of the Government that the value of the company's timber on December 31, 1908, must be determined by the arbitrary book entries of $2.25 and $8.00 is untenable, and contrary to reason and good sense as well as authority.

V.

Other Items Involved in the Case.

In addition to timber stumpage, the reassessment made by the commissioner covered certain other items of capital assets which the company had deducted from its gross receipts in determining its net income. These items and the amount of the additional tax levied thereon are as follows:

(a) Stump lands	$331.98
(b) Wood stumpage or fire wood	186.14
(c) Square timber and cedar products	123.08
(d) Cadillac and Grand Rapids real estate	17.00

The argument hereinbefore made applies with equal force to all of these items, as they all constituted capital assets owned by the company on December 31, 1908, and as they were all deducted at the value they had on that date. It will, therefore, be necessary to call attention only to the facts out of which they arose.

A.

Stump Lands.

During the years 1909, 1910, 1911 and 1912, Mitchell Bros. Co. sold certain stump lands. It deducted from the

gross receipts what it determined was the value of these stump lands on December 31, 1908. The District Court found that the amount deducted was actually the value of such lands on that date (R. p. 106, 107). Instead of permitting the company to deduct the actual value of the lands as of December 31, 1908, the commissioner, in making the reassessment, permitted it to deduct such lands at the rate of $2.00 per acre, that figure having been used in transferring cutover lands from the timber land account into the stump land account, as hereinbefore stated.

The stump lands were owned by the company on December 31, 1908; they were at that time capital assets at their then market value; and at such value they were properly deducted from the gross receipts for the reasons hereinbefore discussed.

B.

THE WOOD STUMPAGE OR FIREWOOD.

The company deducted from its receipts a certain item for wood stumpage (firewood on the stump) converted and sold during the taxing years. This wood stumpage was never carried on the books of the company except as it was a part of the timber land account. In 1903, when the corporation was organized, wood stumpage had no value. It became of value in later years through the creation of a market at Cadillac by the erection of certain charcoal and chemical plants (R. p. 68, 69); and on December 31, 1908, it had a market value of twenty-five cents per cord (R. 17). The company deducted the wood stumpage converted during the taxing years at this value, and the commissioner refused to allow the deduction.

The wood stumpage was owned on December 31, 1908, and was capital assets on that date. Its fair market value at that time was the amount deducted by the com-

pany, as shown by the proofs and as found by the Court (R. p. 107; Findings Nos. XXIII, XXIV, XXV and XXVI). To the extent of such value it either never became income, or, if it became income, it was properly deducted as a charge against manufacturing cost.

C.

THE SQUARE TIMBER AND CEDAR PRODUCTS.

During the year 1912, the company sold a quantity of square timber and cedar products. It deducted from its receipts for that year, the fair market value which such square timber and cedar products had on the stump on December 31, 1908.

As is the case with the timber stumpage, stump lands and wood timber, the square timber and cedar products were capital assets on December 31, 1908. They were deducted at the value which the Court found they had on that date (R. p. 108; Findings Nos. XVII and XXVIII), because as to such value they formed no part of the company's income received within the year.

D.

THE CADILLAC AND GRAND RAPIDS REAL ESTATE.

During the year 1910, Mitchell Bros. Co. sold a parcel of real estate in Cadillac for $5,000 and another parcel in Grand Rapids for $700. The two parcels were bought acquired in 1903 when the corporation was organized. They were carried on the books of the company up to the time they were sold at their original purchase price, viz.: $3,500.00 for the Cadillac property and $500.00 for the Grand Rapids property. The uncontradicted testimony showed and the District Court found (R. p. 108; Finding No. 29) that on December 31, 1908, the fair market value of these properties was $5,000.00 and $700.00 respec-

tively, the amounts for which they sold; and that they had not increased in value from December 31, 1908, to the date of their sale.

The company deducted from its receipts in its returns the amounts of $5,000.00 and $700.00 received for these properties respectively, on the theory that they were capital assets on December 31, 1908, at that value. The commissioner refused to allow the deduction beyond the amount at which the properties had been carried on the books of the company, viz.: $3,500.00 and $500.00, and levied an additional assessment based on the difference between the book value and the selling price. Under the authorities hereinbefore discussed, the action of the company in deducting from gross receipts the values which these properties had on December 31, 1908, was proper. To the extent of such value the amount received was not part of the gross income received within the year.

We ask the affirmance of the judgment below.

MARK NORRIS,
OSCAR E. WAER,
Counsel for Respondent
Mitchell Brothers Company.

APPENDIX

Resume of Treasury Decisions.

The following extracts from Treasury Decisions call attention to all of the rulings made, and all of the instructions issued by the Treasury Department on the question of what is income, gross or net, within the meaning of the Excise Tax Law. If there are any other Treasury Decisions than those referred to which are material to this controversy, they have escaped our attention in the careful search we have made. Italics are ours unless otherwise stated.

TREASURY DECISION No. 1571, December 3, 1909.

"5. Miscellaneous.—Gross income consists of the gross revenue derived from the operation and management of the business and property of the corporation making the return together with all amounts of income (including dividends received on stock of other corporations, joint stock companies, associations, and insurance companies subject to this tax) derived from all other sources as shown by the entries on the books from January 1 to December 31 of the year for which return is made.

It will be noted from these definitions that gross income is practically the same as gross profits, the only difference being that gross income is more inclusive, embracing as it does not only gross profits of the corporation, joint stock company, and association itself, but also all amounts of income received from other sources. It is immaterial whether any item of gross income is evidenced by cash receipts during the year or in such other manner as to entitle it to proper entry on the books of the corporation from January 1 to December 31 for the year in which return is made.

Sale of capital assets.—In ascertaining income derived from the sale of capital assets, if the assets were acquired subsequent to January 1, 1909, the difference between the selling price and the buying

price shall constitute an item of gross income to be added to or subtracted from gross income according to whether the selling price was greater or less than the buying price. *If the capital assets were acquired prior to January 1, 1909, the amount of increment of depreciation representing the difference between the selling and buying price is to be adjusted so as to fairly determine the proportion of the loss or gain arising subsequent to January 1, 1909, and which proportion of the loss or gain arising subsequent to January shall be deducted from or added to the gross income for the year in value does not produce income.*

TREASURY DECISION No. 1588, January 24, 1910.

The provisions of the law require—

1. *That the return shall show the gross income (profit)* received during the year, which is reported in item 3 on Form 637. * * *

To make a correct return it is necessary for the accountant to know—

1. The exact resources and liabilities of the corporation, both on January 1 and December 31 of the year covered by the same.

2. A full statement of the business transacted during the year.

For example: If a manuafacturing corporation has on hand at the beginning of the year as resources, raw materials, materials in process, finished product, cash, bills receivable, accounts receivable, etc., making up the total assets of the company, *a business transaction that results in exchanging these assets, or any part of them for anything of equal income value does not produce income.*

Raw materials, *being of the capital assets of the company,* are changed in form by the addition of different items of expense to produce another form of asset, the finished product, and hence the method of making up the return is as follows: The gross income from the manufacturing business reported in item 3 consists of the difference between the cost of the assets as material and the selling price of the assets as finished product. The selling price

of the finished product is ascertained as follows: The cost of the raw material plus all expenses shown in items 4, 5, 6 and 7, plus per cent of profit, and while all these items of expense are as surely a part of the finished product as is the value of the raw material, yet as such items are expenses and not assets they are segregated and reported as deductions in items 4, 5, 6 and 7, in order to assist the government officer in his comparison and verification of the accuracy of the return.

In making up the gross income to be reported in item 3, the cost of the goods manufactured shall be ascertained *by the addition of a charge to the account of the cost of the goods as manufactured during the year of the sum of the inventory as the beginning of the year, and a credit to the account of the sum of the inventory at the end of the year.* To this amount should be added all items of income received during the year from other sources, including dividends received on stock of other corporations subject to this tax.

In making the inventory on December 31 of each year the appreciation or depreciation in the value of the raw material on hand should be ascertained, as well as that of the finished product, and this loss or gain, as the case may be, is included in the account of the closing calendar year. These articles, the raw material, material in process of manufacture, and the finished product, constitute at the beginning of the year succeeding the inventory the capital assets of the company, and hence, under the rule in paragraph 2 page 9, of Regulations 31, any increase or decrease in value accruing at a time prior to January 1 of the calendar year for which return is made can not be taken as a part of the gross income for that year, but, as noted above, such increase or decrease in value should be included in the account of the prior calendar year.

The rules, as hereinbefore stated, relative to manufacturing corporations also apply to mercantile corporations, and it is not at all material in making a return for the pear 1909 if, as you state, the goods were purchased prior to that time. *On January 1, 1909, the goods referred to constitute capital assets*

at the invoiced value, and only the profits on the same, if sold during the year, are taken as gross income, or if not all sold during the year gross income is found by an addition to the credit side of the account of the sum of the inventory at the close of the year.

TREASURY DECISION No. 1606. March 29, 1910.

38. Cost of manufactured articles, or articles in process of manufacture, held to include original cost of materials used, plus cost of labor, etc.

50. *Sales of stock and bonds are regarded as sales of capital assets and should be so accounted for. (Art. 2, regs. 31.)* But proceeds derived from sale of bonds used in defraying ordinary and necessary expenses are a proper deduction in determining the company's net income.

71. *Where increase or decrease during the year in the value of real estate acquired in previous years, sold or held for sale, can not be accurately determined, such increase or decrease may be pro-rated, as provided by regulations in cases of sale of capital assets.*

72, *Depreciation in value of mines by the removal of ore, if not otherwise ascertainable, may be pro-rated as in the case of sales of capital assets.*

73. Depreciation in value of mines by the removal of ore, if in excess of 5 per cent of investment, to be explained in return rendered.

74. Estimated depreciation in oil or gas wells, buildings, machinery, etc., to be stated in detail, if exceeding 5 per cent of value as previously inventoried.

75. Corporations leasing mines and paying royalties on ore mined not entitled to deduction for depreciation. But corporations owning mines are entitled to allowance for depreciation based on fair estimate, etc.

76. *Removal of timber from timber lands, while depleting the lands to the extent of such removal, is regarded as a change in the form of assets and not a depreciation within the meaning of the act.*

77. Deduction on account of depreciation of property must be based on lifetime of property, its cost, value, and use.

TREASURY DECISION No. 1675, February 14, 1911.

55. *Lands bought previous to January 1, 1909, and sold during the year 1910, should have the profits arising from such sale pro-rated in accordance with the number of years the land was held by the corporation and the number of years the law was in effect, if no accounting of increased value of land was made in returns for previous years.*

75. *The mere removal of timber by cutting from timber lands, unless the timber is otherwise disposed of through sales or plant operations, is considered simply a change in form of assets. If said timber is disposed of through sales or otherwise it is to be accounted for in accordance with regulations governing disposition of capital and other assets.*

80. In case of corporations whose business consists in part or wholly of mining, producing and disposing of deposits of nature (ores, coals, gas petroleum, and sundry minerals) the conduct of such business will be understood to comprehend two classes of gains or losses, viz.:

(a) *The gain or loss resulting from the sale of capital assets, i. e., either the increment or the loss, arising through possessing over a period of time the investment in the same.*

(b) The trading or commercial gain attached to the conduct of the industry, the employment of working capital, the effort and risk involved.

81. *In the ascertainment of net income deduction will be allowed for depreciation arising from exhaustion of deposits of ore, mineral, etc., and for depreciation and obsolescence of improvements, in accordance with general regulations respecting depreciation allowances, on the basis of the original capital investment cost of the properties concerned to the company reporting.*

82. A further deduction will also be allowed, *though not including the same at all in the item of*

gross income (item 3, Form 637), for the unearned increment represented in such properties as at January 1, 1909, which will be determined in general as follows:

83. An estimate should be made as of January 1, 1909, of the fair market value at that date of the minerals, etc., in deposit. This estimate should be formed on the basis of the disposal value of the minerals *in total* and exclusive of value of improvements and development work. This valuation should also be reduced to a unit value—per ton, barrel, etc.

Note.—Values as aforesaid should not be estimated on the basis of the assumed salable value of the output under current operative conditions, less the actual cost of production, because, as hereinbefore stated, the selling price under such conditions comprehends a profit both for carrying the investment in minerals, improvements, and working capital, and for conducting operations in respect of production and disposal of product. The value to be determined as stated must be on the basis of the salable value of the entire deposit of the aggregate units of minerals considered *en bloc* if disposed of in that form. Nor must such valuation comprehend any speculative value which might attach to a sale of the minerals *en bloc,* i. e., a value which might be obtained on the ground that the future would develop a much greater reserve of mineral deposits than were believed to exist at the time estimate as of January 1, 1909, was formed. Any value of this latter character would attach obviously to such additional reserves when developed in future.

84. The unit value as of January 1, 1909, ascertained as above outlined, would indicate the value to be attached at that date to the capital assets disposed of during any calendar year succeeding, *and should be used in determining the unearned increment at January 1, 1909, which may be excluded entirely from the item of gross income, as before explained, in following manner, viz.:*

Value at January 1, 1909, determined in manner outlined, of minerals, etc., which may be removed

and disposed of in any year subsequent thereto _____ $_____

Less the following:

(a) Proportion of depreciation charge applying to exhaustion of minerals disposed of, ascertained as first explained herein on basis of original cost _____ $_____ _____

(b) Royalty paid, if any, on minerals disposed of _____ _____ _____

Balance, being unearned increment at January 1, 1909, to be excluded from gross income item _____ $_____

87. As to the amount to be deducted for depreciation (paragraph 2 preceding) is to be bound on basis of the estimated reserve of minerals, etc., it follows that if it develops such estimate is understated, the cost estimate in the capital asset may be wholly extinguished before all mineral reserves are removed. When this is reached, further deductions for exhaustion of minerals should be discontinued but in such event, it will be noted, *the allowance for unearned increment which is to be excluded entirely from gross income will be correspondingly increased.*

89. *In respect to properties of the character in question which may be acquired by a corporation after January 1, 1909, a deduction will be allowed only as to depreciation arising from exhaustion based on original cost; no exclusion from gross income can be made for unearned increment, as profit arising in sale of such capital assets applies wholly to the period subsequent to January 1, 1909.*

TREASURY DECISION No. 1706. June 9, 1911.

In cases wherein no entry of the appreciation of securities is made on the books and there is no record evidence of the increased value of such assets, this office has not required, and does not require, an accounting for the appreciation as income until the securities shall have been disposed of, at which time *it will be permissible to pro-rate the gain according to the number of years the securities were held by the corporation prior to their sale and ac-*

count as income for the amount properly apportioned to the year in which the securities were disposed of plus a like amount so apportioned for each preceding year such securities were held subsequent to January 1, 1909, the beginning of the period when the corporation tax law became effective.

TREASURY DECISION No. 1727, August 25, 1911.

Third. Relative to amortization of bonds, where a corporation holds bonds which were purchased at a rate above par and said corporation shall proportionately reduce the value of those bonds on its books each year so that the book value shall be the redemption value of the bonds when such bonds become due and payable, *the return of annual net income of the corporation holding such bonds may show the depreciation on account of amortization of such bonds.* The requirement is, however, that the amount carried to the amortization account each year shall be practically proportioned with respect to the difference between the purchase price and the maturing value and the number of years to elapse until the bonds become due and payable. With respect to bond issues where such bonds are disposed of for a price less than par and are redeemable at par, it is also held that because of the fact that such bonds must be redeemed at their face value, the loss sustained by reason of their sale for less than their face value may be pro-rated by the issuing corporation in accordance with the life of the bond.

TREASURY DECISION No. 1742, December 5, 1911.

48. Any increase in the value of the capital assets, as determined by a physical revaluation and taken cognizance of by the corporation in book entries, is gain and must be accounted for as income for the year in which such increase is so recognized and recorded.

62. *In the case of lands bought prior to January 1, 1909, and sold during any subsequent year, the profits arising from such sale, if no accounting of increased value of land was made in return for previous years, should be pro-rated in accordance with the number of years the land was held by the cor-*

poration and the number of years the law was in effect.

78. Where a corporation or insurance company holds bonds which were purchased at a rate above par, and a proportionate deduction of the value of such bonds is made on its books each year so that the book value shall be the redemption value of the bonds when they become due and payable, the return of annual net income may show the depreciation on account of amortization of such bonds. (T. D. 1727.)

85. In the case of corporations owning stocks and bonds or other securities, if an annual adjustment of the value of such securities is made and the adjusted values made a matter of ledger entry, the appreciation of such securities as so entered must be accounted for as income, and the depreciation may be deducted from gross income. If no annual adjustment is made, and the securities are carried from year to year as a permanent investment, there will be neither gain nor loss, as to the principal of such securities, until the same shall have been disposed of, *when the gain or loss as compared with the original cost shall be pro-rated and the amount of such gain or loss apportioned to the years since the incidence of the tax, to-wit, January 1, 1909, shall be added to or deducted from the gross income of the year in which the securities were so disposed of.*

86. Where increase or decrease during the year in the value of real estate acquired in previous years, sold or held for sale, is taken up on the books and the rate can not be accurately determined with respect to individual years, such increase or decrease may be pro-rated as provided by regulations in cases of sale of capital assets.

91. *The mere removal of timber by cutting from timber lands, unless the timber is otherwise disposed of through sales or plant operations, is considered simply a change in form of assets. If said timber is disposed of through sales or otherwise it is to be accounted for in accordance with regulations governing disposition of capital and other assets.*

96. In case of corporations whose business consists in part or wholly of mining, producing, and

disposing of deposits of nature (ores, coals, gas, petroleum, and sundry minerals) the conduct of such business will be understood to comprehend two classes of gains or losses, viz.:

(a) The gain or loss resulting from the sale of capital assets, i. e., either the increment or the loss, arising through possessing over a period of time the investment in the same.

(b) The trading or commercial gain attached to the conduct of the industry, the employment of working capital, the effort and risk involved.

97. In the ascertainment of net income deduction will be allowed for depreciation arising from exhaustion of deposits of ore, mineral, etc., and for depreciation and obsolescence of improvements, in accordance with general regulations respecting depreciation allowances, on the basis of the original capital investment cost of the properties concerned to the company reporting.

98. *A further deduction will also be allowed, through not including the same at all in the item of gross income (item 3, Form 637), for the unearned increment represented in such properties as at January 1, 1909, which will be determined in general as follows:*

99. *An estimate should be made as of January 1, 1909, of the fair market value at that date of the minerals, etc., in deposit.* This estimate should be formed on the basis of the disposal value of the minerals *in total* and exclusive of value and improvements and development work. This valuation should also be reduced to a unit value—per ton, barrel, etc.

Note.—Values, as aforesaid, should not be estimated on the basis of the assumed salable value of the output under current operative conditions, less the actual cost of production, because, as hereinbefore stated, the selling price under such conditions comprehends a profit both for carrying the investment in minerals, improvements, and working capital, and for conducting operations in respect of production and disposal of product. The value to be determined as stated must be on the basis of the salable

value of the entire deposit of the aggregate units of minerals considered *en bloc* if disposed of in that form. Nor must such valuation comprehend any speculative value which might attach to a sale of the minerals *en bloc,* i. e., a value which might be obtained on the ground that the future would develop a much greater reserve of mineral deposits than were believed to exist at the time estimate as of January 1, 1909, was formed. Any value of this latter character would attach obviously to such additional reserves when developed in future.

100. The unit value as of January 1, 1909; ascertained as above outlined, would indicate the value to be attached at that date to the capital assets disposed of during any calendar year succeeding, and should be used in determining the unearned increment, at January 1, 1909, *which may be excluded entirely from the item of gross income, as before explained, in the following manner, viz.:*

Value at Jan. 1, 1909, determined in manner outlined, of minerals, etc., which may be removed and disposed of in any year subsequent thereto $_____

(a) Proportion of depreciation charge applying to exhaustion of minerals disposed of, ascertained as first explained herein on basis of original cost _____ $_____

(b) Royalty paid, if any, on minerals disposed of _____ _____

Balance, being unearned increment at January 1, 1909, to be excluded from gross income item _____ _____

102. Each excise-tax return (Form 637) should be accompanied with memorandum setting forth the extent in amount of the exclusion made from the item gross income for unearned increment realized during the year, as above outlined.

103. As the amount to be deducted for depreciation (paragraph 2 preceding) is to be formed on basis of the estimated reserve of minerals, etc., it follows that if it develops such estimate is understated, the cost investment in the capital assets may be wholly extinguished before all mineral reserves

are removed. When this is reached, further deductions for exhaustion of minerals should be discontinued, *but in such event, it will be noted, the allowance for unearned increment which is to be excluded entirely from gross income, will be correspondingly increased.*

105. *In respect to properties of the character in question which may be acquired by a corporation after January 1, 1909, a deduction will be allowed only as to depreciation arising from exhaustion based on original cost; no exclusion from gross income can be made for unearned increment, as profit arising in sale of such capital assets applies wholly to the period subsequent to January 1, 1909.*

TREASURY DECISION No. 1754, January 22, 1912.

1. In case of corporations whose business consists of either producing, selling transporting, or distributing natural gas, the conduct of such business will be understood to comprehend two classes of gains or losses, viz.: (a) *The gain or loss resulting from the sale of capital assets,* i. e., either the increment or the loss arising through possessing over a period of time the investment in the same; (b) the trading or commercial gain attached to the conduct of the industry, the employment of working capital, the effort and risk involved.

2. *In the ascertainment of net income, deductions will be allowed for depreciation of investment in the field and main lines of such corporations on the basis of exhaustion of deposits.* Claims for depreciation on account of depletion or depreciation in accordance with the regulations based on any value other than the cost of the property plus the cost of development will not be allowed.

3. For the purpose of enabling corporations engaged in the production and transportation of natural gas to properly gauge depreciation of investment in the field and main line divisions on account of depletion to be deducted each year in making their annual return of net income, the following methods are recommended:

First: That the producing gas area of said company be laid off in squares not exceeding 1 square

mile, and that three months prior to September 30 of each year, one or more representative wells be shut in in each square or territory, and that as of September 30 an accurate gauge be taken of the rock pressure of said wells, and the decline in the average rock pressure from year to year shall be considered as the base of determining the exhaustion of deposit. For instance, a corporation may have 80 square miles of territory and the average rock pressure September 30, 1909, may have been 600 pounds per square inch. On September 30, 1910, the average rock pressure may have been 540 pounds, or a decline of 10 per cent, and this percentage is to be applied as a basis of depreciation for the year 1910 on the cost of the field and main line division, less depreciation charged off prior to that date and any salvage value that may remain in the property.

Second: If by reason of lack of area or for any other good and sufficient reason any corporation engaged in the production of gas shall prefer the "volume basis" as more accurately reflecting the rate of exhaustion of deposits, the amount of capital invested to be returned out of the income of any given year may be determined on that basis. In case the "volume basis" is adopted, the volume of each well must be taken with instruments generally recognized as reliable for determining the daily volume produced by each well at stated periods each year, and the percentage of loss in daily production *shall determine the percentage of the capital investment which shall be returnable out of gross income and the proper deduction to be made each year in the return of annual net income as return of capital invested.*

TREASURY DECISION No. 1755, January 22, 1912.

1. In the case of corporations whose business consists of producing and disposing of crude petroleum, the conduct of such business will be understood to comprehend two classes of gains or losses, viz.: (a) *The gain or loss resulting from the sale of capital assets, i. e., either the increment or the loss arising through possessing over a period of time the investment in the same.* (b) The trading

or commercial gain attached to the conduct of the industry, the employment of working capital, and the effort and risk involved.

2. In the ascertainment of net income, deduction will be allowed for depreciation arising from exhaustion of deposits and depreciation and obsolescence of improvements in accordance with the general regulations respecting depreciation allowances, on the basis of the original capital-investment cost, reduced to a cash basis, of the properties concerned to the company reporting. Claims for depreciation on account of depletion of deposits based on any values other than the cost of the property in cash or cash values (including cost of development) will not be considered.

3. In all producing oil fields an average value per barrel of the settled daily production shall be adopted as the guide in determining the value of the property, and the following method in depreciating said values is recommended:

Each corporation will fix this valuation per barrel as of January 1, 1909, or upon the date of commencement of production, if after that date, for ascertaining the deductions for depreciation on the basis of depletion of deposits. This valuation per barrel should be based on the cost of the property to the corporation, plus the cost of the development thereof with a proper deduction from that valuation for the number of years the property has been in operation, and the resulting proportioned decrease in daily production of oil. With this basis per barrel fixed as of January 1, 1909, or at the date of commencement of production, if after January 1, 1909, the value of the property as a whole is to be determined by applying this unit value per barrel to the daily average production for the month of December, or other representative month, in the year for which the return is made. The representative month chosen shall be the same in each year. This unit valuation per barrel is to be retained in arriving at all future depreciation deductions, except where an additional production is secured by drilling or an additional production is acquired by purchases in which case a new average rate per barrel based upon the actual

cash invested in such development, or in the new properties and their development, may be adopted. The amount of income each year to be applied to the return of the cash investment shall be ascertained by multiplying the unit valuation ascertained as required above by the difference between the daily average production in barrels during the representative month of each year. The product of such multiplication will be the amount deductible from gross income on account of return of cash investment based upon the rate of depletion of deposits.

TREASURY DECISION No. 1833, February 18, 1913.

Items Nos. 99, 100, 101, and 103 of T. D. No. 1742 are modified so as to read as follows:

No. 99. The note is amended so that is shall read:

Note.—Values, as aforesaid, should not be estimated on the basis of the assumed salable value of the output under current operative conditions, less the actual cost of production, because, as hereinbefore stated, the selling price under such conditions comprehends a profit both for carrying the investment in coals, etc., improvements and working capital, and for conducting operations in respect of production and disposal of product. The value to be determined as stated must be on the basis of the salable value en bloc of the entire deposit of minerals and mineralized property owned, exclusive of improvements and development work, if the same were disposed of in that form.

No. 100 is amended to read:

The unit value as of January 1, 1909, ascertained as above outlined, would indicate the value to be attached at that date to the capital assets disposed of during any calendar year succeeding. *The amount claimed as a deduction from gross income on account of unearned increment shall be shown separately in the deductions from gross income in the return of annual net income.*

No. 101 is amended to read:

The precise detailed manner in which the estimate of value of minerals, etc., as at January 1, 1909, shall be formed, must naturally be determined by

each corporation interested. Every corporation claiming and making a deduction for unearned increment, as provided in section 100 preceding, shall maintain an official book record of the properities owned by it in connection with this unearned increment as claimed, and which record shall show the general ledger or general balance sheet value thereof, together with the estimated amount of appreciated value in such properities in excess of general balance sheet values, as of January 1, 1909, together with all evidence and information on basis of which such appreciated value was formed. This estimate must be formed on the lines and basis indicated in the "note," section 99, namely, the salable value of the entire deposit considered en bloc. This record should also present clearly and fully the transactions during each year in respect of quantities of minerals disposed of and for which deductions are made respectively for depreciation and unearned increment, together with the amount thereof. No deduction for unearned increment will be allowed unless the aforesaid record is kept nor unless the evidence as to the estimates of quantity of minerals in deposit and the valuation thereof are accepted by the department. *Values determined and recorded as of January 1, 1909, as aforesaid, should be used in the compilation of all subsequent years' excise tax returns.*

In case it subsequently develops the property possesses a greater quantity of mineral, etc., reserve than was in the aggregate estimated as of January 1, 1909, only such an amount of aggregate value can be assigned to such excess mineral tonnage as of January 1, 1909, as it was at said date estimated by the company attached to the property and was not assigned by it, as hereinbefore provided, to the specified tonnage in the property.

No. 103 is amended to read:

As to the amount to be deducted for depletion of deposits (Regulation No. 101) is to be formed on basis of the estimated reserve of minerals, etc., it follows that if it develops such estimate is understated, the cost investment and estimated unearned increment in the capital asset may be wholly ex-

tinguished before all mineral reserves are removed. When this is reached, further deductions for exhaustion of minerals should be discontinued.

TREASURY DECISION No. 2130, January 18, 1915.

If for the purpose of the special excise tax no adjustment of the value of securities acquired prior to January 1, 1909, had been made or taken into either side of the account in the return of annual net income subsequent to January 1, 1909, the gain or loss will be determined in accordance with the rule set out in T. D. 2005; *that is, the gain or loss will be determined on the basis of the difference between the actual cost and selling price and prorated according to the number of years the securities were held.*

Supreme Court, U. S.
FILED
MAY 2 1917
JAMES D. MAHER
Clerk

THE SUPREME COURT OF THE UNITED STATES

October Term, 1916.

EDWARD J. DOYLE,
Collector of Internal Revenue,
Petitioner,

vs.

No. [redacted]492

MITCHELL BROS. CO.,
Respondent.

Answer and Brief of Respondent in Opposition to Petition for Writ of Certiorari

To the Circuit Court of Appeals for the Sixth Circuit.

MARK NORRIS and
OSCAR E. WAER,
Attorneys for Respondent.

[illegible] PRINTING CO., DETROIT, MICH. 1917

THE SUPREME COURT OF THE UNITED STATES

October Term, 1916.

EMANUEL J. DOYLE,
Collector of Internal Revenue,
Petitioner,

vs. No.....

MITCHELL BROS. CO.,
Respondent.

Answer and Brief of Respondent in Opposition to Petition for Writ of Certiorari.

I.

Mitchell Bros. Co., by its attorneys, prays that the petition of the Solicitor General on behalf of Emanuel J. Doyle, Collector, for a Writ of Certiorari to review the judgment by the Court of Appeals of the Sixth Circuit in the above entitled cause be denied.

II.

Question Involved.

The Solicitor General has not stated correctly the question involved in this case and the facts out of which that question arises.

The question in this case is *not* whether a timber owning and operating concern is entitled to deduct from the proceeds of the timber sold the difference between the gross proceeds of the sales of timber and lumber made during the year and the moneys expended in cutting and marketing the timber, the result of such course being to wipe out all income for purposes of taxation under the Corporation Excise Tax Law. The question in this case is whether a timber operating company is entitled to deduct from its gross receipts for the taxing year the value on January 1, 1909, of the capital assets which it has disposed of during the year. To use a concrete illustration: A timber company owns timber on January 1, 1909 (when the Corporation Excise Law of August 5, 1909, became effective), the fair market value of which is $50,000. It manufactures and sells such timber during the year 1912 for $75,000. What is its taxable income from this transaction for the year 1912? Is it $25,000 or is it $75,000?

III.

The Facts in the Case.

The facts of this case are these: Mitchell Bros. Company was and is engaged in the manufacture and sale of lumber. The company purchased all of its timber lands prior to January 1, 1909, when the excise tax law became operative. Most of the lands were purchased many years ago by W. W. Mitchell and A. W. Mitchell, who carried on the business as co-partners until 1903, when the present corporation was organized. Some time prior to the reorganization, the partners revalued their lands, placing various prices on various descriptions, which prices approximated an average valuation of $20.00 per acre. The lands were turned over to the corporation, paid for in stock on this basis, and have remained on the

books at the same valuation to this date. There has been nothing added since the incorporation, all taxes being absorbed in each year's business; and the increase in value since that time has never been taken account of on the books (R. 117, 118; Finding VII).

At about the time of its organization, the company adopted, in its bookkeeping, the following method of keeping its timber land account: At the end of each year, there was transferred from the timber land account into the lumber account, the timber which had been cut and manufactured into lumber during the year, and there was transferred into a stump land account the lands which had been cut over during the year. This transfer was made by crediting the timber land account with all hardwood and hemlock timber cut at the rate of $2.25 per thousand, with all pine timber cut at the rate of $8.00 per thousand, and with all lands cut over at the rate of $2.00 per acre; and by making a corresponding charge of the same items to the timber and stump land accounts respectively. It was estimated at that time that, by using these figures of $2.25 and $8.00 per thousand for stumpage, and $2.00 per acre for stump lands, the timber land account would just about be wiped out when all the timber was removed. On account of closer cutting in later years, and on account of improved methods and utilization of by-products originally regarded as worthless, this proved untrue, but the company, nevertheless, continued to use the same figures in its bookkeeping down to the present time (Rec. 118; Finding VIII). These figures, however, have not been considered as in any way indicative of the actual market value of the company's timber during recent years, and the figures have been used for purposes of bookkeeping only (Record p. 74).

After the passage of the Corporation Excise Tax Law of August 5, 1909, and preparatory to making its returns

of income under the law, the officers of the company determined what was, in their opinion, the fair market value on December 31, 1908, the day before the law became operative, of the timber stumpage owned by the company on that date. Valuations per thousand, log scale, were placed on the different kinds of timber on the basis of what the stumpage would have sold for in open market on December 31, 1908 (Rec. 119; Finding IX). The District Court found that the valuations thus fixed were not excessive, and that the fair market value of the timber stumpage of the company on December 31, 1908, was actually equal to such valuation (Record pp. 122, 123). Counsel for the Government did not question this finding.

In compliance with the provisions of the Corporation Excise Tax Law, the company made a return in each of the years 1909, 1910, 1911 and 1912. In computing its taxable income in each of such returns, the company deducted from its gross receipts the actual market value on December 31, 1908, of the timber stumpage cut and converted during the year covered by the tax. This value was arrived at by taking the total number of feet, log scale, of the various kinds of timber cut during the year and applying thereto the value per thousand which had been fixed as of December 31, 1908. The District Court found that the amount deducted for the various years for timber stumpage cut and converted was actually the market value of such timber on December 31, 1908 (Record p. 123). This finding was not questioned by the Government, as was none of the other findings of fact.

This absorption of the value of the stumpage on January 1, 1909, did not operate to wipe out all of the taxable income of Mitchell Bros. Company. The company accounted to the Government for all the profit derived from the manufacture and sale of its timber, and it also accounted to the Government for all the increase in value

which accrued after December 31, 1908. Thus for the year 1909, it paid an excise tax on a net income of about $1.25 per thousand feet; for 1910, $2.40 per thousand feet; for 1911 and 1912 about $3.00 per thousand feet (Rec. pp. 92-111).

An assessment was duly made by the Commissioner of Intrnal Revenue upon each of the returns for the years mentioned, and the excise taxes so levied were paid by the company. Later on, the Commissioner made an additional assessment for each of the four years. This assessment, insofar as the timber stumpage is concerned, was based upon the difference between the actual market value of the stumpage on December 31, 1908, and the value of such stumpage as determined by the book entries of $2.25 per thousand for hardwood and hemlock, and $8.00 per thousand for pine. That is, instead of permitting the company to deduct the actual market value of the stumpage on December 31, 1908, the Government permitted it to deduct only the value as determined by these book entries.

The District Court held that the timber lands of Mitchell Bros. Company were capital assets on January 1, 1909, when the excise tax law became effective, at their then fair market value; and that the company's taxable income was represented by its gross receipts less operating expenses and less the fair market value on January 1, 1909, of the stumpage consumed (Record pp. 28, 32).

The District Court did not hold, as stated in the petition of the Solicitor General, that "insofar as stumpage was concerned, there was no income at all, but merely a conversion of capital." Mitchell Bros. Company had paid the excise tax on all of the profits or income derived from the *manufacture* and *sale* of its timber, and it had also accounted to the Government for and paid the excise

tax on all of the increase in value which accrued after December 31, 1908.

The Circuit Court of Appeals affirmed the judgment of the District Court and later denied a motion for rehearing. The Circuit Court of Appeals rendered an able and well reasoned decision, to which we respectfully refer this court.

IV.

Petitioner's Grounds for the Writ.

The petition of the Solicitor General gives four reasons for the allowance of the writ. We shall discuss them briefly in their order.

1. *The Sargent Land Case, 242 U. S. 503.*

The Sargent Land Company case involved royalties received under leases of mining property, and this Court held that such royalties were income within the meaning of the Corporation Excise Tax Law. The question involved in the case at bar was not before this Court, and this Court expressly so stated. The decision of the Court of Appeals in the case at bar is in no way inconsistent with the decision of this Court in the Sargent case. The royalties received from the leases in the Sargent case were held to be in the nature of rent and therefore taxable as income. In the case at bar, no questions of royalty, rent, or anything of a similar nature, are involved. The only question in the case at bar is whether a piece of timber having a known value and which is owned by a corporation on December 31, 1908, is capital, so that when such piece of timber is sold at a later period only the portion in excess of its value on December 31, 1908, is taxable income within the meaning of the Corporation Excise Tax Law.

The Solicitor General cites the case of Kauri Timber Co., Ltd., vs. Commissioners of Taxes (1913), A. C. 771,

in support of his petition. That case arose under the Land and Income Assessment Act of 1908 (No. 95 of the Consolidated Statutes of New Zeeland, S. S. 71, 79, 87), which provided for a tax upon income derived from business, employment or emolument. The act provided that:

> "In ascertaining the income derived from business, employment or emolument, no deduction shall be made in respect to any of the following items: * * * (c) *Investment of capital; expenditure of capital; loss of capital; capital withdrawn.*"

It will be seen that a mere statement of the statutory provisions involved in the case makes it wholly inapplicable to the provisions of the Corporation Excise Tax Law.

The Solicitor General says in his petition that:

> "The position of the respondent, as affirmed by the Court of Appeals, has a certain want of broad equity" (Petition p. 6).

We are unable to see any want of equity in our contentions or in the decision of the Court of Appeals. We ask nothing more than that in the construction of the excise tax law, a timber owning and operating concern shall be shown the same consideration as any other corporation; that the measure of its tax under the law shall be its income, and that such income shall be computed like the income of every other corporation. In other words, that a timber owning and operating concern shall be entitled to deduct from its gross receipts the cost of its raw materials if purchased after January 1, 1909, or the value of such materials on January 1, 1909, if they were owned at that time.

To overturn the decision of the Court of Appeals is to make arbitrary and unjust discriminations between the taxpaying corporation which owns timber on December 31, 1908, and the one which acquires its timber or other raw products on January 1, 1909, or on any subsequent

date. To illustrate this is to establish the absurdity, injustice and unreasonableness of the resulting situation.

Company A owns $100,000 in cash on December 31, 1908, and buys $100,000 worth of timber or other raw material on January 1, 1909. It manufactures that timber or other raw material during the year and sells its manufactured product for the gross amount of $200,000. Its manufacturing, operating and selling expenses, including the purchase price of its raw materials, are $175,000. Its profits at the end of the year are $25,000 and its original capital of $100,000 is unimpaired. Under the provisions of the excise tax law, its taxable income is exactly $25,000.

Company B owns or purchases $100,000 worth of timber lands on December 31, 1908. It manufactures that timber during the year 1909 and sells the manufactured product for the gross amount of $200,000. Its manufacturing, operating and selling expense, inclusive of the purchase price or value of its timber on December 31, 1908, is $175,000. It has on hand at the end of the year $125,000 in money but no timber or other assets. Is it possible that Congress intended to tax Company B on an income of $125,000 while Company A is taxed on an income of only $25,000?

Both companies started out with $100,000 assets or capital. Both companies end up with $125,000 in money. Yet, under the claim of the government, one company's net income taxable under the law has been $125,000 while the other company's net income has been only $25,000.

The Solicitor General construes the decision of the Court of Appeals as a holding that the *annual appreciation* of timber lands should be taxed as income, and says that it is not only impossible to value such annual appreciation, but that the tax based on such annual appreciation falls upon the very person who should not pay,

namely, the person who is endeavoring to develop his trees as a steady income-bearing proposition. Both of the points suggested are answered very conclusively by the situation which exists in the case at bar. In the case at bar no difficulty was found in arriving at the taxable income under the law, and no one has claimed that it is necessary each year to value the annual appreciation of the timber lands. The respondent in the case at bar valued its timber lands as of January 1, 1909, and the valuation it placed upon them was found by the court to be correct and was in no way questioned by the government. When timber was sold in 1909, 1910, 1911 and 1912, the respondent accounted to the government for the amount received for the timber less the operating expenses and less the value which the timber had on January 1, 1909. The government therefore received all the tax to which it was entitled upon any appreciation which the timber had from January 1, 1909, up to the date of its sale, and also upon any operating profit which the respondent made from the manufacture and sale of that timber. The second point raised by the Solicitor General should also give him no concern. It is the position of the government that the total receipts from the sale of timber are income, so under that view of the case it makes little difference to the taxpayer whether the tax is computed year by year or whether it is computed all together. The government takes it all in any event, and the injustice which the Solicitor General seeks to avoid is hardly as severe as the one he seeks to impose.

2. *The case of Lynch vs. Hornby.*

The Solicitor General says that because this Court granted a Writ of Certiorari in the Hornby case it should also grant the writ in the case at bar, and refers this Court for the discussion on this point to the brief in sup-

port of the petition in that case. As the Solicitor General has not served us with a copy of his brief in the Hornby application, we have no means of knowing what his argument is on this point. We may state, however, that the Hornby case involved the rights of a stockholder to dividends paid out of surplus accumulated prior to the incidence of the taxing law, while in the case at bar no rights of stockholders are involved. A reversal by this Court of the Hornby case might be in no way inconsistent with the decision rendered by the Circuit Court of Appeals in the case at bar.

3. *The Brushaber and the Baltic Mining Co. cases.*

The Solicitor General contends that the opinions of this Court in the two cases mentioned are inconsistent with the decision of the Circuit Court of Appeals in the case at bar. We can see no inconsistency. The Solicitor General says that the Circuit Court of Appeals in its decision holds (contrary to the two cases cited) that the test is not the income received during the taxing year *from* capital, but the nature and value of the capital prior to the time the taxing law went into effect. We do not so understand the decision of the Court of Appeals, and it certainly does not dispose of the case upon any such basis. The Circuit Court of Appeals held that the respondent had properly paid the excise tax on *all the income which it had received during the taxing year from capital*, and it need not pay an excise tax on that portion of its *receipts*—not income—which represented capital owned when the taxing law went into effect; that, while the excise tax was measured by the income irrespective of its source, the amount received from the sale of capital assets owned when the taxing law went into effect was income only to the extent that it represented gain or profit accruing and received during the taxing years.

The Solicitor General says that "There would have been very little revenue derived from the Corporation Excise Tax of 1909 if all income derived from capital accumulated prior to that year was to be excluded". Under the decision of the Mitchell case, no income derived *from* capital accumulated prior to 1909 was excluded. Mitchell Brothers accounted for and paid a tax on all of the operating profit derived from the manufacture and sale of its timber, and it accounted for and paid a tax on all of the increase in value which accrued subsequent to January 1, 1909. It was and is the contention of the respondent, and the Circuit Court of Appeals held, that the assets which the company had on December 31, 1908, were its capital on that date, and it was only the income *from* that capital which furnished the measure of its tax.

In this holding the Circuit Court of Appeals has done nothing more than to follow the construction placed upon the Corporation Excise Tax Law by the governmental department having its administration and execution in charge during the entire life of the statute. The Solicitor General says that "Clearly there would have been very little revenue derived from the Corporation Excise Tax of 1909 if all income derived from capital accumulated prior to that year was to be excluded." As already pointed out, no one has asked that income derived *from* capital shall be excluded. We ask only that the capital itself owned prior to January 1, 1909, and disposed of afterward shall not be included, while the gain or profit derived from that capital should be included. And the Solicitor General is very much in error in saying that very little revenue would have been derived from the Corporation Excise Tax Law if all assets accumulated prior to January 1, 1909, were to be considered as capital at their then value. As a matter of fact, the government collected about $100,000,000 in taxes under the excise tax

law, and every dollar of that $100,000,000 was levied and collected by the Internal Revenue Department on the precise basis underlying the decision of the Court of Appeals in the case at bar.

That the "income" of a corporation which should be the basis of the excise tax under the law of 1909 did not include what was capital on December 31, 1908, was the construction placed upon this law from the very beginning by the governmental department having its administration and execution in charge. In the first decision of the Treasury Department dealing with this subject and laying down rules for the guidance of collectors, the Treasury Department said:

> "It will be noted from these definitions *that gross income is practically the same as gross profits.*
>
> *Sale of Capital Assets*—In ascertaining income derived from the sale of capital assets, if the assets were acquired subsequent to January 1, 1909, the difference between the selling price and the buying price shall constitute an item of gross income to be added to or subtracted from gross income according to whether the selling price was greater or less than the buying price. If the capital assets were acquired prior to January 1, 1909, the amount of increment or depreciation representing the difference between the selling and buying price is to be adjusted, so as to fairly determine the proportion of the loss or gain arising subsequent to January 1, 1909, and which proportion shall be deducted from or added to the gross income for the year in which the sale was made." (Treasury Decision No. 1571, dated Dec. 3, 1909.)

A little later the Treasury Department said:

> *"The return shall show the gross income (profit) received during the year* * * *
>
> The rules, as hereinafter stated, relative to manufacturing corporations also apply to mercantile corporations, and it is not at all material in making a return for the year 1909, if the goods were purchased prior to that time. *On January 1, 1909, the*

goods referred to constitute capital assets at the invoiced value, and only the profits on the same, if sold during the year, are taken as gross income, or if not all sold during the year, gross income is found by an addition to the credit side of the account of the sum of the inventory at the close of the year." (Treasury Decision No. 1588, dated Jan. 24, 1910.)

And on February 14, 1911, the Department laid down the rule:

"If timber is disposed of through sales or otherwise it is to be accounted for in accordance with regulations governing *disposition of capital and other assets".* (Treasury Decision No. 1675, Sec. 75.)

And, as a matter of fact, Treasury rulings *covering the entire period during which the law was in effect* have treated the words "gross income" as not meaning "gross receipts", but as being used in contra-distinction to capital. The Department in *all* of its rulings made it plain to collectors that income meant "profit" and not "receipts"; and that *it did not include receipts which represented capital.*

Treasury Decisions Nos.
1571
1588
1606, Sections 50, 71, 72.
1675, Sections 37, 48, 55, 75, 80, 81, 83, 84, 85.
1706
1727
1742, Sections 43, 48, 55, 62, 78, 85, 86, 91, 97, 98, 99, 101, 102, 103, 104, 105.
1754
1755
1833
2130

A brief resume of these decisions, and we have been

unable to find any others pertinent to this discussion, will be found in the Appendix to this brief.

While the rulings of the Treasury Department and the construction placed by that department upon the language used by Congress are not controlling, they are, nevertheless, significant and entitled to some force, particularly in view of the fact that such rulings were promulgated *and, to the extent stated, consistently reaffirmed during the entire life of the statute.*

It is well settled that the long-continued construction of a statute by the Department charged with its execution should not be overruled except for cogent reasons.

United States v. Military Construction Co., 204 Fed. 153.
Schell v. Fauche, 138 U. S. 572.
Brown v. United States, 113 U. S. 571.
Iowa v. McFarland, 110 U. S. 471, 485.
Smythe v. Fiske, 23 Wall. 374, 382.
United States v. Hill, 120 U. S. 182.
Peabody v. Stark, 16 Wall. 240.
Hahn v. United States, 107 U. S. 406.

In *Schell v. Fauche,* 138 U. S. 572, the Supreme Court of the United States said on this point:

> "In all cases of ambiguity, the contemporaneous construction, not only of the courts but of the departments, and even of the officials whose duty it is to carry the law into effect, *is universally held to be* controlling." (Citing numerous cases.)

Not even in making the re-assessment involved in the case at bar, did the Commissioner of Internal Revenue construe "gross amount of the income" as meaning "gross receipts", but permitted the company to deduct from its gross receipts, on account of stumpage consumed, the amount charged against the timber lands account on the books of the company at the rate of $2.25

and $8.00 per thousand, the Commissioner's theory being that such figures conclusively established the value of the stumpage as a capital asset.

In making the claim in the case at bar that "gross amount of the income" was intended to mean "gross receipts," the government not only denies the very principle upon which the re-assessment in this case was based, but it takes a position antagonistic to *all the rulings* it has made and to *all of the instructions* it has issued pertaining to this feature of the law. The Treasury Department itself, whose practice it undoubtedly is to construe revenue laws most strongly against the taxpayer, has never even thought of making the claim the government now makes, but on the contrary, it has again and again interpreted the law as making the measure of the tax the income *derived from capital*, and not *receipts representing capital.*

See Treasury Decisions above cited.

If the contention made by the government in this case is sustained, it will mean that Mitchell Bros. Company, and a few other timber owners against whom additional assessments may have been levied, will be singled out from amongst the vast number of corporations, which, during the years from 1909 to 1912, when the excise tax law was in effect, paid to the government some twenty-five millions of dollars per year in excise taxes, *all of which were, under the express instructions and direct rulings of the Treasury Department, based, computed, levied and paid upon the theory that taxable income under the law did not include receipts representing what was capital on December 31, 1908.* Is it possible that the courts would be justified in now placing upon the extinct excise tax law a construction entirely at variance with and directly antagonistic to the construction which the Department charged with its administration and execution placed

upon it during the entire life of the statute, *and upon which construction that Department based and levied excise taxes to the amount of over one hundred millions of dollars?*

4. *Meaning of terms "capital" and "income."*

The Solicitor General claims that the opinion of the Court of Appeals shows a confusion as to the true legal meaning of "capital" as distinguished from "income," which must be exceedingly burdensome to the public and the Government in the execution of the taxing laws. The opinion of the Court of Appeals does not present any confusion to us and the case at bar clearly demonstrates that the difficulties feared by the Solicitor General have not and will not be encountered.

The Court of Appeals holds that property owned on December 31, 1908, is capital at its then fair market value, and that in case of a sale during a subsequent taxing year the amount realized less the value on December 31, 1908, is income, while the remainder is a conversion of capital and not part of the income. Precisely the same rule has been applied to the merchant used by the Solicitor General as an illustration. If he owns his stock of goods on December 31, 1908, or bought his stock of goods during January, 1909, that stock was his capital. When he sold it, the government in no case asked him to account for the total receipts as income—the government asked him to account only for the difference between his total receipts and the cost of his stock. It was only this difference which represented income received within the year.

The Solicitor General's contention seems to be that all of the receipts of a business are income, and that nothing can be deducted for the purchase or value of raw materials. So that if a merchant owns at the beginning of the year or purchases the first of the year a stock of goods for $100,000, sells such stock for $90,000 gross and pays

out $10,000 as selling expense, his total taxable income for the year has been $80,000. This may be fine for the government, but it is not prosperous business for the taxpayer to be compelled to pay an income tax on $80,000 when he has had no income at all and has lost $20,000 of his capital besides.

But the Solicitor General may say that the merchant can charge against his gross receipts the cost of his raw materials. If a merchant can do so then a company buying, manufacturing and selling timber can surely do the same. Lumber surely is no different than sugar, coffee or dry goods so far as the taxation of incomes derived from these commodities is concerned. If a company buying, manufacturing and selling timber can charge back against gross receipts the cost of the timber in ascertaining its income, why cannot a company which owns its timber at the time the law went into effect charge back against gross receipts the value which that timber had on January 1, 1909. As far as figuring gain, profit or income for the taxing year is concerned, the situation is precisely the same.

To use an illustration applicable to the situation existing in the case at bar: Company A buys its logs in the open market at $4.25 per thousand feet—the same as the average value of Mitchell Bros. Company's consumed stumpage as found by the court—manufactures the same into lumber and sells it for cash or on credit. The cost of the logs it has paid out to the sellers as part of its expense of operation—an integral element in the expense of producing its manufactured product—it is entitled to deduct from "the gross amount of the income of such corporation * * * received within the year." In this it differs not a whit from any merchandising corporation which buys goods at wholesale and sells at retail. The law and the department regulations allow and

provide for such deduction. It therefore paid no excise tax on the amount expended in the purchase of logs. Now Mitchell Bros. Company differs from Company A only in the fact that it *owned* logs of the same market value as those Company A *purchased*. It treated those logs in the same way, sold the lumber at the same figure and received the same amount, but owing solely to its ownership, it is to be compelled to pay excise tax on the full value of its consumed stumpage, while Company A pays nothing on the same value. Sustaining such a contention would put out of business every lumber manufacturing company which owned stumpage. And it would discrimate unjustly and without reason against such companies on account of their ownership of *stumpage* instead of its *cash equivalent*. The market value of the timber which such companies own is precisely what that timber costs them, when they manufacture the timber, as part of the manufacturing cost.

Mitchell v. Insurance Co., 92 Mich. 594.

A construction of the statute which will lead to such results as are above indicated is certainly one to be avoided. As has been well said by this Court in the case of *Knowlton v. Moore*, 178 U. S. 41, 77, "Where the particular construction of a statute will occasion great inconvenience or produce inequality and injustice, that view is to be avoided if another and more reasonable interpretation is present in the statute."

And while the constitutional inhibition that "all duties, imposts and excises shall be uniform throughout the United States," exacts only a gographical uniformity (Brushaber v. Union Pacific R. R. Co., Jan. 24, 1916, U. S. Advance Opinions, p. 236), it is equally true that, as stated by Mr. Justice Field in *Pollock v. Farmers Loan & Trust Co.*, 157 U. S. 595, "If there were any doubt as to the intention of the State to make a grant of the right

to impose indirect taxes, subject to the condition that such taxes shall be in all respects *uniform and impartial,* that doubt shall be resolved in the interest of justice in favor of the taxpayers."

And aside from the provisions of our constitution, it is a fundamental principle of taxation under a system of government like ours that taxes shall, as far as possible, operate equally and uniformly. The rule is well stated by Mr. Gray in his standard work on "Limitations of Taxing Power," in the following language:

> "The spirit of equality which pervades the constitutional law of taxation may be invoked as a guide to the interpretation of laws and constitutional provisions * * * The doctrine of proportionate equality in taxation has been received by American students of constitutional law so that in cases involving interpretation of tax laws, *the idea of equality is constantly present; and that construction is favored which tends toward equality.*"

In this connection, we may also call the attention of the Court to the well established principle that the imposition of a tax by a government is a burden upon private interests laid upon private property under the necessary exercise of an arbitrary power, and because of the character of the power exercised, the rule is universal that when the question arises whether given property should be held subject to the tax, the taxing power must make it clear that the statute was intended to cover the property in question.

> Gill v. Bartlett (C. C. A. 1st Cir.), 224 Fed. 927, 928.

The rule has been clearly and explicitly laid down by this Court itself in *Spreckles Sugar Co. v. McClain,* 192 U. S. 397, 416, wherein the Court, speaking through Mr. Justice Harlan, quoted with approval the following language:

"It is the well settled rule that the citizen is exempt from taxation, unless the same is imposed by clear and unequivocal language, and that, *where the consruction of a tax is doubtful, the doubt is to be resolved in favor of those upon whom the tax is sought to be laid.*"

To the same effect see:

Swan & Finch Co. v. United States, 190 U. S. 143, 146.

Benziger v. United States, 192 U. S. 38, 55.

Eidman v. Martinez, 184 U. S. 578.

American Net & Twine Co. v. Worthingham, 141 U. S. 468, 474.

Hartranft v. Wiegmann, 121 U. S. 609, 616.

United States v. Isham, 17 Wall (84 U. S.) 504.

Equitable Trust Co. v. Selden, Fed. Cas. No. 4508 (Affirmed 94 U. S. 419.)

Shallus v. United States, 162 Fed. 653, 656.

Hayes & Co. v. United States, 150 Fed. 63, 66.

United States v. Fish Co., 146 Fed. 104, 106.

Voight v. Miholovitch, 125 Fed. 78, 83.

Hempstead v. Thomas, 122 Fed. 539.

Commercial Bank v. Sandford, 103 Fed. 98, 100.

Southern R. R. v. North Carolina Corp. Comm. 97 Fed. 513, 518.

United States v. Merck, 91 Fed. 639, 640.

In re Southern Pacific R. R. Co., 82 Fed. 311, 313.

Mathewson v. United States, 71 Fed. 394, 395.

In re Wetherell, 60 Fed. 267, 270.

Rice v. United States, 53 Fed. 910, 912.

Penn Co. v. McClain, 105 Fed. 367, 370.

In *United States v. Isham*, 17 Wall 84 U. S. 504), the Court said:

> "If there is a doubt as to the liability of an instrument for taxation, the construction is in favor of the exemption, because, a tax cannot be imposed without clear and express words for that purpose."

What was said by the Court in Pennsylvania Co. v. McClain, 105 Fed. 367, 370, could be said with equal truth and with equal force in this case:

> "Enough has been said to show that while the exact meaning of the statute is not free from perplexity (to use the language of Mr. Justice White in Knowlton v. Moore, 178 U. S. 41), it is only after resolving every doubt in favor of the government that the sense intended for can be read into the act; and even then the construction is strained and unnatural. This being so, I think the government's contention should not prevail, upon the well understood principle of taxation—that a doubtful tax does not exist. Before the property of a citizen can be taken under the exercise of a taxing power, it is necessary that the statute be clear and unambiguous, so there may be no doubt about the intention of the state to take the property of the citizen for public purposes. As I have attempted to show and as I think must be conceded, the section under consideration certainly cannot be said to express clearly the meaning for which the government argues, while the opposite construction seems to give a much more natural and reasonable meaning to the words."

In *Swan & Finch Co. v. United States*, 190 U. S. 143, 146, the Court, in holding that an exporter was not entitled to a certain exemption, gave among its reasons:

> "Third. *The uniform construction placed by the department charged with the execution of the statute has been against it.*
>
> Fourth. Being a governmental grant of a privilege or benefit, it is to be construed in favor of the

government and against the party claiming the grant. Where the burden is placed upon a citizen, if there be a doubt as to the extent of the burden, it is resolved in favor of the citizen, but where a privilege is granted, any doubt is resolved in favor of the government. In Hartranft v. Wiegmann, 121 U. S. 609, 619, the one rule was thus stated: 'We are of opinion that the decision of the Circuit Court was correct. *But if the question were one of doubt, the doubt would be resolved in favor of the importer, as duties are never imposed on the citizen upon vague or doubtful interpretation*'." (Citing numerous cases.)

The Corporation Excise Tax Law of August 5, 1909, is no exception to the rule thus laid down. The courts have held that the excise tax law should be strictly construed; and that all reasonable doubts in respect thereto should be resolved against the government and in favor of the citizen.

Pa. Steel Co. v. Railway Co. (C. C. A. 2nd Cir.), 198 Fed. 774, 775.

Mutual Benefit Life Ins. Co. v. Harold, 198 Fed. 199. (Judgment affirmed 201 Fed. 918).

Building & Loan Assn. v. Harold, 203 Fed. 876.

And, in the case at bar, as in the case of Swan & Finch Co. v. United States, above referred to, the *uniform construction placed by the government charged with the execution of the statute has been against the contention now made by the United States.* In view of that uniform construction, which was always and consistently to the effect that the statute did not seek to tax receipts representing capital; and in view of the further fact that when the statute is viewed in its most favorable light for the government, it must be held that there is indeed grave doubt that the language of the law is sufficiently comprehensive to include receipts derived from the sale or

conversion of capital assets, it must necessarily follow that the contention of the government cannot be sustained. To sustain it would be to resolve every doubt in favor of the government and against the taxpayer.

We respectfully submit that the petition for the Writ of Certiorari should be denied.

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APPENDIX.

RESUME OF TREASURY DECISIONS.

The following extracts from Treasury Decisions call attention to all of the rulings made, and all of the instructions issued by the Treasury Department on the question of what is income, gross or net, within the meaning of the Excise Tax Law. If there are any other Treasury Decisions than those referred to which are material to this controversy, they have escaped our attention in the careful search we have made. Italics are ours unless otherwise stated.

Treasury Decision No. 1571, December 3, 1909.

"5. Miscellaneous.—Gross income consists of the gross revenue derived from the operation and management of the business and property of the corporation making the return, together with all amounts of income (including dividends received on stock of other corporations, joint stock companies, associations, and insurance companies subject to this tax) derived from all other sources as shown by the entries on the books from January 1 to December 31 of the year for which return is made.

It will be noted from these definitions that gross income is practically the same as gross profits, the only difference being that gross income is more inclusive, embracing as it does not only gross profits of the corporation, joint stock company, and association itself, but also all amounts of income received from other sources. It is immaterial whether any item of gross income is evidenced by cash receipts during the year or in such other manner as to entitle it to proper entry on the books of the corporation from January 1 to December 31 for the year in which return is made.

Sale of capital assets.—In ascertaining income derived from the sale of capital assets, if the assets were acquired subsequent to January 1, 1909, the difference between the selling price and the buying price shall constitute an item of gross income to be added to or subtracted from gross income according to whether the selling price was greater or less than the buying price. *If the capital assets were acquired prior to January 1, 1909, the amount of increment or depreciation representing the difference between the selling and buying price is to be adjusted so as to fairly determine the proportion of the loss or gain arising subsequent to January 1, 1909, and which proportion of the loss or gain arising subsequent to January shall be deducted from or added to the gross income for the year in which the sale was made."*

Treasury Decision No. 1588, January 24, 1910.

The provisions of the law require—

1. *That the return shall show the gross income (profit)* received during the year, which is reported in item 3 on Form 637. * * *

To make a correct return it is necessary for the accountant to know—

1. The exact resources and liabilities of the corporation, both on January 1 and December 31 of the year covered by the same.

2. A full statement of the business transacted during the year.

For example: If a manufacturing corporation has on hand at the beginning of the year as resources, raw materials, materials in process, finished product, cash, bills receivable, accounts receivable, etc., making up the total assets of the company, *a business transaction that results in exchanging these assets, or any part of them, for anything of equal value does not produce income.*

Raw materials, *being of the capital assets of the company,* are changed in form by the addition of different items of expense to produce another form of asset, the finished product, and hence the method of making up the return is as follows: The gross

income from the manufacturing business reported in item 3 consists of the difference between the cost of the assets as material and the selling price of the assets as finished product. The selling price of the finished product is ascertained as follows: The cost of the raw material plus all expenses shown in items 4, 5, 6 and 7, plus per cent of profit, and while all these items of expense are as surely a part of the finished product as is the value of the raw material, yet as such items are expenses and not assets they are segregated and reported as deductions in items 4, 5, 6 and 7, in order to assist the government officer in his comparison and verification of the accuracy of the return.

In making up the gross income to be reported in item 3, the cost of the goods manufactured shall be ascertained *by the addition of a charge to the account of the cost of the goods as manufactured during the year of the sum of the inventory as the beginning of the year, and a credit to the account of the sum of the inventory at the end of the year.* To this amount should be added all items of income received during the year from other sources, including dividends received on stock of other corporations subject to this tax.

In making the inventory on December 31 of each year the appreciation or depreciation in the value of the raw material on hand should be ascertained, as well as that of the finished product, and this loss or gain, as the case may be, is included in the account of the closing calendar year. These articles, the raw material, material in process of manufacture, and the finished product, constitute at the beginning of the year succeeding the inventory the capital assets of the company, and hence, under the rule in paragraph 2, page 9, of Regulations 31, any increase or decrease in value accruing at a time prior to January 1 of the calendar year for which return is made can not be taken as a part of the gross income for that year, but, as noted above, such increase or decrease in value should be included in the account of the prior calendar year.

The rules, as hereinbefore stated, relative to manufacturing corporations also apply to mercan-

tile corporations, and it is not at all material in making a return for the year 1909 if, as you state, the goods were purchased prior to that time. *On January 1, 1909, the goods referred to constitute capital assets at the invoiced value, and only the profits on the same, if sold during the year, are taken as gross income, or if not all sold during the year gross income is found by an addition to the credit side of the account of the sum of the inventory at the close of the year.*

Treasury Decision No. 1606, March 29, 1910.

38. Cost of manufactured articles, or articles in process of manufacture, held to include original cost of materials used, plus cost of labor, etc.

50. *Sales of stock and bonds are regarded as sales of capital assets and should be so accounted for. (Art. 2, regs. 31.)* But proceeds derived from sale of bonds used in defraying ordinary and necessary expenses are a proper deduction in determining the company's net income.

71. *Where increase or decrease during the year in the value of real estate acquired in previous years, sold or held for sale, can not be accurately determined, such increase or decrease may be pro-rated, as provided by regulations in cases of sale of capital assets.*

72. *Depreciation in value of mines by the removal of ore, if not otherwise ascertainable, may be pro-rated as in the case of sales of capital assets.*

73. Depreciation in value of mines by the removal of ore, if in excess of 5 per cent of investment, to be explained in return rendered.

74. Estimated depreciation in oil or gas wells, buildings, machinery, etc., to be stated in detail, if exceeding 5 per cent of value as previously inventoried.

75. Corporations leasing mines and paying royalties on ore mined not entitled to deduction for depreciation. But corporations owning mines are entitled to allowance for depreciation based on fair estimate, etc.

76. *Removal of timber from timber lands, while depleting the lands to the extent of such removal, is regarded as a change in the form of assets and not a depreciation within the meaning of the act.*

77. Deduction on account of depreciation of property must be based on lifetime of property, its cost, value, and use.

Treasury Decision No. 1675, February 14, 1911.

55. *Lands bought previous to January 1, 1909, and sold during the year 1910, should have the profits arising from such sale pro-rated in accordance with the number of years the land was held by the corporation and the number of years the law was in effect, if no accounting of increased value of land was made in returns for previous years.*

75. *The mere removal of timber by cutting from timber lands, unless the timber is otherwise disposed of through sales or plant operations, is considered simply a change in form of assets. If said timber is disposed of through sales or otherwise it is to be accounted for in accordance with regulations governing disposition of capital and other assets.*

80. In case of corporations whose business consists in part or wholly of mining, producing and disposing of deposits of nature (ores, coals, gas, petroleum, and sundry minerals) the conduct of such business will be understood to comprehend two classes of gains or losses, viz.:

(a) *The gain or loss resulting from the sale of capital assets, i. e., either the increment, or the loss, arising through possessing over a period of time the investment in the same.*

(b) The trading or commercial gain attached to the conduct of the industry, the employment of working capital, the effort and risk involved.

81. *In the ascertainment of net income deduction will be allowed for depreciation arising from exhaustion of deposits of ore, mineral, etc., and for depreciation and obsolescence of improvements, in accordance with general regulations respecting depreciation allowances, on the basis of the original*

capital investment cost of the properties concerned to the company reporting.

82. A further deduction will also be allowed, *though not including the same at all in the item of gross income (item 3, Form 637), for the unearned increment represented in such properties as at January 1, 1909,* which will be determined in general as follows:

83. An estimate should be made as of January 1, 1909, of the fair market value at that date of the minerals, etc., in deposit. This estimate should be formed on the basis of the disposal value of the minerals *in total* and exclusive of value of improvements and development work. This valuation should also be reduced to a unit value—per ton, barrel, etc.

Note.—Values as aforesaid should not be estimated on the basis of the assumed salable value of the output under current operative conditions, less the actual cost of production, because, as hereinbefore stated, the selling price under such conditions comprehends a profit both for carrying the investment in minerals, improvements, and working capital, and for conducting operations in respect of production and disposal of product. The value to be determined as stated must be on the basis of the salable value of the entire deposit of the aggregate units of minerals considered *en bloc* if disposed of in that form. Nor must such valuation comprehend any speculative value which might attach to a sale of the minerals *en bloc,* i. e., a value which might be obtained on the ground that the future would develop a much greater reserve of mineral deposits than were believed to exist at the time estimate as of January 1, 1909, was formed. Any value of this latter character would attach obviously to such additional reserves when developed in future.

84. The unit value as of January 1, 1909, ascertained as above outlined, would indicate the value to be attached at that date to the capital assets disposed of during any calendar year succeeding, *and should be used in determining the unearned increment at January 1, 1909, which may be excluded en-*

tirely from the item of gross income, as before explained, in following manner, viz.:

Value at January 1, 1909, determined in manner outlined, of minerals, etc., which may be removed and disposed of in any year subsequent thereto _____ $_____

Less the following:

(a) Proportion of depreciation charge applying to exhaustion of minerals disposed of, ascertained as first explained herein on basis of original cost _____ $_____ _____

(b) Royalty paid, if any, on minerals disposed of _____ _____ _____

Balance, being unearned increment at January 1, 1909, to be excluded from gross income item _____ $_____

87. As to the amount to be deducted for depreciation (paragraph 2 preceding) is to be bound on basis of the estimated reserve of minerals, etc., it follows that if it develops such estimate is understated, the cost estimate in the capital asset may be wholly extinguished before all mineral reserves are removed. When this is reached, further deductions for exhaustion of minerals should be discontinued, but in such event, it will be noted, *the allowance for unearned increment which is to be excluded entirely from gross income will be correspondingly increased.*

89. *In respect to properties of the character in question which may be acquired by a corporation after January 1, 1909, a deduction will be allowed only as to depreciation arising from exhaustion based on original cost; no exclusion from gross income can be made for unearned increment, as profit arising in sale of such capital assets applies wholly to the period subsequent to January 1, 1909.*

Treasury Decision No. 1706, June 9, 1911.

In cases wherein no entry of the appreciation of securities is made on the books and there is no record evidence of the increased value of such assets, this office has not required, and does not require, an accounting for the appreciation as income until the securities shall have been disposed of, at which time *it will be permissible to pro-rate the gain according to the number of years the securities were held by the corporation prior to their sale and account as income for the amount properly apportioned to the year in which the securities were disposed of plus a like amount so apportioned for each preceding year such securities were held subsequent to January 1, 1909,* the beginning of the period when the corporation tax law became effective.

Treasury Decision No. 1727, August 25, 1911.

Third. Relative to amortization of bonds, where a corporation holds bonds which were purchased at a rate above par and said corporation shall proportionately reduce the value of those bonds on its books each year so that the book value shall be the redemption value of the bonds when such bonds become due and payable, *the return of annual net income of the corporation holding such bonds may show the depreciation on account of amortization of such bonds.* The requirement is, however, that the amount carried to the amortization account each year shall be practically proportioned with respect to the difference between the purchase price and the maturing value and the number of years to elapse until the bonds become due and payable. With respect to bond issues where such bonds are disposed of for a price less than par and are redeemable at par, it is also held that because of the fact that such bonds must be redeemed at their face value, the loss sustained by reason of their sale for less than their face value may be pro-rated by the issuing corporation in accordance with the life of the bond.

Treasury Decision No. 1742, December 5, 1911.

48. Any increase in the value of the capital assets, as determined by a physical revaluation and taken cognizance of by the corporation in book entries, is gain and must be accounted for as income for the year in which such increase is so recognized and recorded.

62. *In the case of lands bought prior to January 1, 1909, and sold during any subsequent year, the profits arising from such sale, if no accounting of increased value of land was made in return for previous years, should be pro-rated in accordance with the number of years the land was held by the corporation and the number of years the law was in effect.*

78. Where a corporation or insurance company holds bonds which were purchased at a rate above par, and a proportionate deduction of the value of such bonds is made on its books each year so that the book value shall be the redemption value of the bonds when they become due and payable, the return of annual net income may show the depreciation on account of amortization of such bonds. (T. D. 1727.)

85. In the case of corporations owning stocks and bonds or other securities, if an annual adjustment of the value of such securities is made and the adjusted values made a matter of ledger entry, the appreciation of such securities as so entered must be accounted for as income, and the depreciation may be deducted from gross income. If no annual adjustment is made, and the securities are carried from year to year as a permanent investment, there will be neither gain nor loss, as to the principal of such securities, until the same shall have been disposed of, *when the gain or loss as compared with the original cost shall be pro-rated and the amount of such gain or loss apportioned to the years since the incidence of the tax, to-wit, January 1, 1909, shall be added to or deducted from the gross income of the year in which the securities were so disposed of.*

86. Where increase or decrease during the year in the value of real estate acquired in previous years, sold or held for sale, is taken up on the books and the rate can not be accurately determined with respect to individual years, such increase or decrease may be pro-rated as provided by regulations in cases of sale of capital assets.

91. *The mere removal of timber by cutting from timber lands, unless the timber is otherwise disposed of through sales or plant operations, is considered simply a change in form of assets. If said timber is disposed of through sales or otherwise it is to be accounted for in accordance with regulations governing disposition of capital and other assets.*

96. In case of corporations whose business consists in part or wholly of mining, producing, and disposing of deposits of nature (ores, coals, gas, petroleum, and sundry minerals) the conduct of such business will be understood to comprehend two classes of gains or losses, viz.:

(a) The gain or loss resulting from the sale of capital assets, i. e., either the increment, or the loss, arising through possessing over a period of time the investment in the same.

(b) The trading or commercial gain attached to the conduct of the industry, the employment of working capital, the effort and risk involved.

97. In the ascertainment of net income deduction will be allowed for depreciation arising from exhaustion of deposits of ore, mineral, etc., and for depreciation and obsolescence of improvements, in accordance with general regulations respecting depreciation allowances, on the basis of the original capital investment cost of the properties concerned to the company reporting.

98. *A further deduction will also be allowed, through not including the same at all in the item of gross income (item 3, Form 637), for the unearned increment represented in such properties as at January 1, 1909, which will be determined in general as follows:*

99. *An estimate should be made as of January 1, 1909, of the fair market value at that date of the*

minerals, etc., in deposit. This estimate should be formed on the basis of the disposal value of the minerals *in total* and exclusive of value and improvements and development work. This valuation should also be reduced to a unit value—per ton, barrel, etc.

Note.—Values, as aforesaid, should not be estimated on the basis of the assumed salable value of the output under current operative conditions, less the actual cost of production, because, as hereinbefore stated, the selling price under such conditions comprehends a profit both for carrying the investment in minerals, improvements, and working capital, and for conducting operations in respect of production and disposal of product. The value to be determined as stated must be on the basis of the salable value of the entire deposit of the aggregate units of minerals considered *en bloc* if disposed of in that form. Nor must such valuation comprehend any speculative value which might attach to a sale of the minerals *en bloc*, i. e., a value which might be obtained on the ground that the future would develop a much greater reserve of mineral deposits than were believed to exist at the time estimate as of January 1, 1909, was formed. Any value of this latter character would attach obviously to such additional reserves when developed in future.

100. The unit value as of January 1, 1909; ascertained as above outlined, would indicate the value to be attached at that date to the capital assets disposed of during any calendar year succeeding, and should be used in determining the unearned increment, at January 1, 1909, *which may be excluded entirely from the item of gross income, as before explained, in the following manner*, viz.:

Value at January 1, 1909, determined in manner outlined, of minerals, etc., which may be removed and disposed of in any year subsequent thereto _____ $_____

(a) Proportion of depreciation charge applying to exhaustion of minerals disposed

of, ascertained as first explained herein on basis of original cost		$	
(b) Royalty paid, if any, on minerals disposed of			
Balance, being unearned increment at January 1, 1909, to be excluded from gross income item			

102. Each excise-tax return (Form 637) should be accompanied with memorandum setting forth the extent in amount of the exclusion made from the item gross income for unearned increment realized during the year, as above outlined.

103. As the amount to be deducted for depreciation (paragraph 2 preceding) is to be formed on basis of the estimated reserve of minerals, etc., it follows that if it develops such estimate is understated, the cost investment in the capital asset may be wholly extinguished before all mineral reserves are removed. When this is reached, further deductions for exhaustion of minerals should be discontinued, *but in such event, it will be noted, the allowance for unearned increment which is to be excluded entirely from gross income will be correspondingly increased.*

105. *In respect to properties of the character in question which may be acquired by a corporation after January 1, 1909, a deduction will be allowed only as to depreciation arising from exhaustion based on original cost; no exclusion from gross income can be made for unearned increment, as profit arising in sale of such capital assets applies wholly to the period subsequent to January 1, 1909.*

Treasury Decision No. 1734, January 22, 1912.

1. In case of corporations whose business consists of either producing, selling, transporting, or distributing natural gas, the conduct of such business will be understood to comprehend two classes of gains or losses, viz.: (a) *The gain or loss resulting from the sale of capital assets,* i. e., either the increment or the loss arising through possessing

over a period of time the investment in the same; (b) the trading or commercial gain attached to the conduct of the industry, the employment of working capital, the effort and risk involved.

2. *In the ascertainment of net income, deductions will be allowed for depreciation of investment in the field and main lines of such corporations on the basis of exhaustion of deposits.* Claims for depreciation on account of depletion or depreciation in accordance with the regulations based on any value other than the cost of the property plus the cost of development will not be allowed.

3. For the purpose of enabling corporations engaged in the production and transportation of natural gas to properly gauge depreciation of investment in the field and main line divisions on account of depletion to be deducted each year in making their annual return of net income, the following methods are recommended:

First: That the producing gas area of said company be laid off in squares not exceeding 1 square mile, and that three months prior to September 30 of each year, one or more representative wells be shut in in each square or territory, and that as of September 30 an accurate gauge be taken of the rock pressure of said wells, and the decline in the average rock pressure from year to year shall be considered as the base of determining the exhaustion of deposit. For instance, a corporation may have 80 square miles of territory and the average rock pressure September 30, 1909, may have been 600 pounds per square inch. On September 30, 1910, the average rock pressure may have been 540 pounds, or a decline of 10 per cent, and this percentage is to be applied as a basis of depreciation for the year 1910 on the cost of the field and main line divisions, less depreciation charged off prior to that date and any salvage value that may remain in the property.

Second: If by reason of lack of area or for any other good and sufficient reason any corporation engaged in the productions of gas shall prefer the "volume basis" as more accurately reflecting the rate of exhaustion of deposits, the amount of capital invested to be returned out of the income of any

given year may be determined on that basis. In case the "volume basis" is adopted, the volume of each well must be taken with instruments generally recognized as reliable for determining the daily volume produced by each well at stated periods each year, and the percentage of loss in daily production *shall determine the percentage of the capital investment which shall be returnable out of gross income and the proper deduction to be made each year in the return of annual net income as return of capital invested.*

Treasury Decision No. 1755, January 22, 1912.

1. In the case of corporations whose business consists of producing and disposing of crude petroleum, the conduct of such business will be understood to comprehend two classes of gains or losses, viz.: (a) *The gain or loss resulting from the sale of capital assets, i. e., either the increment or the loss arising through possessing over a period of time the investment in the same.* (b) The trading or commercial gain attached to the conduct of the industry, the employment of working capital, and the effort and risk involved.

2. In the ascertainment of net income, deduction will be allowed for depreciation arising from exhaustion of deposits and depreciation and obsolescence of improvements in accordance with the general regulations respecting depreciation allowances, on the basis of the original capital-investment cost, reduced to a cash basis, of the properties concerned to the company reporting. Claims for depreciation on account of depletion of deposits based on any values other than the cost of the property in cash or cash values (including cost of development) will not be considered.

3. In all producing oil fields an average value per barrel of the settled daily production shall be adopted as the guide in determining the value of the property, and the following method in depreciating said values is recommended.

Each corporation will fix this valuation per barrel as of January 1, 1909, or upon the date of com-

mencement of production, if after that date, for ascertaining the deductions for depreciation on the basis of depletion of deposits. This valuation per barrel should be based on the cost of the property to the corporation, plus the cost of the development thereof with a proper deduction from that valuation for the number of years the property has been in operation, and the resulting proportioned decrease in daily production of oil. With this basis per barrel fixed as of January 1, 1909, or at the date of commencement of production, if after January 1, 1909, the value of the property as a whole is to be determined by applying this unit value per barrel to the daily average production for the month of December, or other representative month, in the year for which the return is made. The representative month chosen shall be the same in each year. This unit valuation per barrel is to be retained in arriving at all future depreciation deductions, except where an additional production is secured by drilling or an additional production is required by purchases, in which case a new average rate per barrel based upon the actual cash invested in such development, or in the new properties and their development, may be adopted. The amount of income each year to be applied to the return of the cash investment shall be ascertained by multiplying the unit valuation ascertained as required above by the difference between the daily average production in barrels during the representative month of each year. The product of such multiplication will be the amount deductible from gross income on account of return of cash investment based upon the rate of depletion of deposits.

Treasury Decision No. 1833, February 18, 1913.

Items Nos. 99, 100, 101, and 103 of T. D. No. 1742 are modified so as to read as follows:

No. 99. The note is amended so that it shall read:

Note.—Values, as aforesaid, should not be estimated on the basis of the assumed salable value of the output under current operative conditions, less the actual cost of production, because, as herein-

before stated, the selling price under such conditions comprehends a profit both for carrying the investment in coals, etc., improvements and working capital, and for conducting operations in respect of production and disposal of product. The value to be determined as stated must be on the basis of the salable value *en bloc* of the entire deposit of minerals and mineralized property owned, exclusive of improvements and development work, if the same were disposed of in that form.

No 100 is amended to read:

The unit value as of January 1, 1909, ascertained as above outlined, would indicate the value to be attached at that date to the capital assets disposed of during any calendar year succeeding. *The amount claimed as a deduction from gross income on account of unearned increment shall be shown separately in the deductions from gross income in the return of annual net income.*

No. 101 is amended to read:

The precise detailed manner in which the estimate of value of minerals, etc., as at January 1, 1909, shall be formed, must naturally be determined by each corporation interested. Every corporation claiming and making a deduction for unearned increment, as provided in section 100 preceding, shall maintain an official book record of the properties owned by it in connection with this unearned increment as claimed, and which record shall show the general ledger or general balance sheet value thereof, together with the estimated amount of appreciated value in such properties in excess of general balance sheet values, as of January 1, 1909, together with all evidence and information on basis of which such appreciated value was formed. This estimate must be formed on the lines and basis indicated in the "note," section 99, namely, the salable value of the entire deposit considered *en bloc*. This record should also present clearly and fully the transactions during each year in respect of quantities of minerals disposed of and for which deductions are made respectively for depreciation and unearned increment, together with the amount thereof. No deduc-

tion for unearned increment will be allowed unless the aforesaid record is kept, nor unless the evidence as to the estimates of quantity of minerals in deposit and the valuation thereof are accepted by the department. *Values determined and recorded as of January 1, 1909, as aforesaid should be used in the compilation of all subsequent years' excise tax returns.*

In case it subsequently develops the property possesses a greater quantity of mineral, etc., reserve than was in the aggregate estimated as of January 1, 1909, only such an amount of aggregate value can be assigned to such excess mineral tonnage as of January 1, 1909, as it was at said date estimated by the company attached to the property and was not assigned by it, as hereinbefore provided, to the specified tonnage in the property.

No. 103 is amended to read:

As to the amount to be deducted for depletion of deposits (Regulation No. 101) is to be formed on basis of the estimated reserve of minerals, etc., it follows that if it develops such estimate is understated, the cost investment and estimated unearned increment in the capital asset may be wholly extinguished before all mineral reserves are removed. When this is reached, further deductions for exhaustion of minerals should be discontinued.

Treasury Decision No. 2130, January 18, 1915.

If for the purpose of the special excise tax no adjustment of the value of securities acquired prior to January 1, 1909, had been made or taken into either side of the account in the return of annual net income subsequent to January 1, 1909, the gain or loss will be determined in accordance with the rule set out in T. D. 2005; *that is, the gain or loss will be determined on the basis of the difference between the actual cost and selling price and pro-rated according to the number of years, the securities were held.*

DOYLE, COLLECTOR OF INTERNAL REVENUE, v. MITCHELL BROTHERS COMPANY.

CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

No. 492. Argued March 4, 5, 6, 1918.—Decided May 20, 1918.

The purpose of the Corporation Tax Act of August 5, 1909, c. 6, 36 Stat. 11, 112, § 38, is not to tax property as such, or the mere conversion of property, but to tax the conduct of the business of corporations organized for profit by a measure based upon the gainful returns from their business operations and property from the time the act took effect.

The act employs the term "income" in its natural and obvious sense, as importing something distinct from principal or capital, and conveying the idea of gain or increase arising from corporate activities.

While a conversion of capital may result in income, in the sense of the act, where the proceeds include an increment of value, such is not the case where the increment existed when the act took effect.

In distinguishing preëxisting capital from income subject to the act, it is a mere question of method whether a deduction be made from gross receipts in ascertaining gross income, or from gross income, by way of depreciation, in ascertaining net income.

Before the Corporation Tax Act, a lumber company bought timber land

to supply its mills, and after the act it manufactured part of the timber into lumber, which it sold. *Held*, that the amount by which the timber so used had increased in value between the date of purchase and the effective date of the act was not an element of income to be considered in computing the tax.

The principle upon which the removal of minerals by mining companies has been held not to produce a depreciation within the meaning of the act is inapplicable to the case of a company engaged in the business of manufacturing and selling lumber from timber supplied by its own timber lands, and which sells the lands incidentally after the timber is removed.

The income is to be determined from the actual facts, as to which the corporate books are only evidential.

235 Fed. Rep. 686, affirmed.

THE case is stated in the opinion.

The Solicitor General, with whom *Mr. Wm. C. Herron* was on the brief, for petitioner.

Mr. Mark Norris, with whom *Mr. Oscar E. Woer* was on the brief, for respondent.

Mr. Robert R. Reed, by leave of court, filed a brief on behalf of the Investment Bankers' Association of America, as *amicus curiæ*.

MR. JUSTICE PITNEY delivered the opinion of the court.

This was an action to recover from the Collector additional taxes assessed against the respondent under the Corporation Excise Tax Act of August 5, 1909, c. 6, 36 Stat. 11, 112, § 38, and paid under protest. The District Court gave judgment for the plaintiff, which was affirmed by the Circuit Court of Appeals (225 Fed. Rep. 437; 235 Fed. Rep. 686), and the case comes here on certiorari.

It was submitted at the same time with several other cases decided this day, arising under the same act.

The facts are as follows: Plaintiff is a lumber manufacturing corporation which operates its own mills, manufactures into lumber therein its own stumpage, sells the lumber in the market, and from these sales and sales of various by-products makes its profits, declares its dividends, and creates its surplus. It sells its stumpage lands, so-called, after the timber is cut and removed. Its sole business is as described; it is not a real estate trading corporation. Plaintiff acquired certain timber lands at its organization in 1903 and paid for them at a valuation approximately equivalent to $20 per acre. Owing to increases in the market price of stumpage the market value of the timber land, on December 31, 1908, had become approximately $40 per acre.[1] The company made no entry upon its books representing this increase, but each year entered as a profit the difference between the original cost of the timber cut and the sums received for the manufactured product, less the cost of manufacture. After the passage of the Excise Tax Act, and preparatory to making a return of income for the year 1909, the company revalued its timber stumpage as of December 31, 1908, at approximately $40 per acre. The good faith and accuracy of this valuation are not in question, but the figures representing it never were entered in the corporate books.

Under the act the company made a return for each of the years 1909, 1910, 1911, 1912, and in each instance deducted from its gross receipts the market value, as of December 31, 1908, of the stumpage cut and converted during the year covered by the tax. There appears to have been no change in its market value during these years.

The Commissioner of Internal Revenue having al-

[1] The valuations were based upon the quantity of standing timber, at certain prices per thousand feet for the different varieties. The approximate acreage equivalent is employed for convenience.

lowed a deduction of the cost of the timber in 1903 and refused to allow the difference between that cost and the fair market value of the timber on December 31, 1908, the question is whether this difference (made the basis of the additional taxes) was income for the years in which it was converted into money, within the meaning of the act.

Other items are involved in the case, arising from the sale of certain stump lands, certain by-products, and a parcel of real estate, but they raise no different question from that which arises upon the valuation of the stumpage, and need not be further mentioned.

The act became effective January 1, 1909, and provided for the annual payment by every domestic corporation "organized for profit and having a capital stock represented by shares" of an excise tax "equivalent to one per centum upon the entire net income over and above five thousand dollars received by it from all sources during such year," with exceptions not now material. It declared that such net income should be ascertained by deducting from the gross income received within the year from all sources the expenses paid within the year out of income in the maintenance and operation of business and property, including rentals and the like; losses sustained within the year and not compensated by insurance or otherwise, including a reasonable allowance for depreciation of property; interest paid within the year to a limited extent; taxes; and amounts received within the year as dividends upon stock of other corporations subject to the same tax. In the case of a corporation organized under the laws of a foreign country, the net income was to be ascertained by taking into account the gross income received within the year "from business transacted and capital invested within the United States and any of its Territories, Alaska, and the District of Columbia," with deductions for expenses of maintenance and operation,

business losses, interest, and taxes, all referable to that portion of its business transacted and capital invested within the United States, etc.

An examination of these and other provisions of the act makes it plain that the legislative purpose was not to tax property as such, or the mere conversion of property, but to tax the conduct of the business of corporations organized for profit by a measure based upon the gainful returns from their business operations and property from the time the act took effect. As was pointed out in *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, 145, the tax was imposed "not upon the franchises of the corporation irrespective of their use in business, nor upon the property of the corporation, but upon the doing of corporate or insurance business and with respect to the carrying on thereof;" an exposition that has been consistently adhered to. *McCoach* v. *Minehill & Schuylkill Haven Railway Co.*, 228 U. S. 295, 300; *United States* v. *Whitridge*, 231 U. S. 144, 147; *Anderson* v. *Forty-two Broadway Co.*, 239 U. S. 69, 72.

When we come to apply the act to gains acquired through an increase in the value of capital assets acquired before and converted into money after the taking effect of the act, questions of difficulty are encountered. The suggestion that the entire proceeds of the conversion should be still treated as the same capital, changed only in form and containing no element of income although including an increment of value, we reject at once as inconsistent with the general purpose of the act. Selling for profit is too familiar a business transaction to permit us to suppose that it was intended to be omitted from consideration in an act for taxing the doing of business in corporate form upon the basis of the income received "from all sources."

Starting from this point, the learned Solicitor General has submitted an elaborate argument in behalf of the

Government, based in part upon theoretical definitions of "capital," "income," "profits," etc., and in part upon expressions quoted from our opinions in *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, 147, and *Anderson* v. *Forty-two Broadway Co.*, 239 U. S. 69, 72, with the object of showing that a conversion of capital into money always produces income, and that for the purposes of the present case the words "gross income" are equivalent to "gross receipts"; the insistence being that the entire proceeds of a conversion of capital assets should be treated as gross income, and that by deducting the mere cost of such assets we arrive at net income. The cases referred to throw little light upon the present matter, and the expressions quoted from the opinions were employed by us with reference to questions wholly remote from any that is here presented.

The formula that the entire receipts derived from a conversion of capital assets after deducting cost value must be treated as net income, so far as it is applied to a conversion of assets acquired before the act took effect and so as to tax as income any increased value that accrued before that date, finds no support in either the letter or the spirit of the act, and brings the former into incongruity with the latter. If the gross receipts upon such a conversion are to be treated as gross income, what authority have we for deducting either the cost or the previous market value of the assets converted in order to arrive at net income? The deductions specifically authorized are only such as expenses of maintenance and operation of the business and property, rentals, uncompensated losses, depreciation, interest, and taxes. There is no express provision that even allows a merchant to deduct the cost of the goods that he sells.

Yet it is plain, we think, that by the true intent and meaning of the act the entire proceeds of a mere conversion of capital assets were not to be treated as income.

Whatever difficulty there may be about a precise and scientific definition of "income," it imports, as used here, something entirely distinct from principal or capital either as a subject of taxation or as a measure of the tax; conveying rather the idea of gain or increase arising from corporate activities. As was said in *Stratton's Independence* v. *Howbert*, 231 U. S. 399, 415: "Income may be defined as the gain derived from capital, from labor, or from both combined."

Understanding the term in this natural and obvious sense, it cannot be said that a conversion of capital assets invariably produces income. If sold at less than cost, it produces rather loss or outgo. Nevertheless, in many if not in most cases there results a gain that properly may be accounted as a part of the "gross income" received "from all sources"; and by applying to this the authorized deductions we arrive at "net income." In order to determine whether there has been gain or loss, and the amount of the gain, if any, we must withdraw from the gross proceeds an amount sufficient to restore the capital value that existed at the commencement of the period under consideration.

This has been recognised from the beginning by the administrative officers of the Government. Shortly after the passage of the act, and before the time (March 1, 1910) for making the first returns of income, the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, promulgated Regulations No. 31, under date December 3, 1909, for the guidance of collectors and other subordinate officers in the performance of their duties under the act. These prescribed, with respect to manufacturing companies, that gross income should consist of the difference between the price received for the goods as sold and the cost of such goods as manufactured; cost to be "ascertained by an addition of a charge to the account of the cost of goods as

manufactured during the year of the sum of the inventory at beginning of the year and a credit to the account of the sum of the inventory at the end of the year." In the case of mercantile companies, gross income was to be the "amount ascertained through inventory, or its equivalent, which shows the difference between the price received for goods sold and the cost of goods purchased during the year, with an addition of a charge to the account of the sum of the inventory at beginning of the year and a credit to the account of the sum of the inventory at the end of the year." And as to miscellaneous corporations, gross income was to be "the gross revenue derived from the operation and management of the business and property of the corporation," with all income derived from other sources. The matter of income arising from a profitable sale of capital assets was dealt with specifically in such a way as to limit the tax to income arising after the effective date of the act. This was done by adopting the rule that an advance in value arising during a period of years should be so adjusted that only so much as properly was attributable to the time subsequent to January 1, 1909, (December 31, 1908, would have been more precise) should be subjected to the tax.[1] Subsequent treasury regulations, promulgated from time to time (T. D. 1606, March 29, 1910,

[1] Extract from Treasury Regulations No. 31, issued December 3, 1909.

Sale of capital assets.—In ascertaining income derived from the sale of capital assets, if the assets were acquired subsequent to January 1, 1909, the difference between the selling price and the buying price shall constitute an item of gross income to be added to or subtracted from gross income according to whether the selling price was greater or less than the buying price. If the capital assets were acquired prior to January 1, 1909, the amount of increment or depreciation representing the difference between the selling and buying price is to be adjusted so as to fairly determine the proportion of the loss or gain arising subsequent to January 1, 1909, and which proportion shall be deducted from or added to the gross income for the year in which the sale was made.

paragraphs 40, 71, 76; T. D. 1675, February 14, 1911, paragraphs 37, 55, 75; T. D. 1742, December 15, 1911, paragraphs 43, 62, 86, 91,) adhered to the same rule with respect to lands bought prior to January 1, 1909, and sold during a subsequent year, prescribing, however, that the profits, when not otherwise accurately determinable, should be prorated according to the time elapsed before and after the act took effect; and gave to it an application especially pertinent here, one of the regulations reading: "The mere removal of timber by cutting from timber lands, unless the timber is otherwise disposed of through sales or plant operations, is considered simply a change in form of assets. If said timber is disposed of through sales or otherwise it is to be accounted for in accordance with regulations governing disposition of capital and other assets."

In our opinion these regulations correctly interpret the act in its application to the facts of the present case. When the act took effect, plaintiff's timber lands, with whatever value they then possessed, were a part of its capital assets, and subsequent change of form by conversion into money did not change the essence. Their increased value since purchase, as that value stood on December 31, 1908, was not in any proper sense the result of the operation and management of the business or property of the corporation while the act was in force. Nor is the result altered by the mere fact that the increment of value had not been entered upon plaintiff's books of account. Such books are no more than evidential, being neither indispensable nor conclusive. The decision must rest upon the actual facts, which in the present case are not in dispute.

The plaintiff, in making up its income tax returns for the years 1909, 1910, 1911, and 1912, deducted from its gross receipts the admittedly accurate valuation as of December 31, 1908, of the stumpage cut and converted dur-

ing the year covered by the tax. There having been no change in market values during these years, the deduction did but restore to the capital in money that which had been withdrawn in stumpage cut, leaving the aggregate of capital neither increased nor decreased, and leaving the residue of the gross receipts to represent the gain realized by the conversion, so far as that gain arose while the act was in effect. This was in accordance with the true intent and meaning of the act.

It may be observed that it is a mere question of methods, not affecting the result, whether the amount necessary to be withdrawn in order to preserve capital intact should be deducted from gross receipts in the process of ascertaining gross income, or should be deducted from gross income in the form of a depreciation account in the process of determining net income. In either case the object is to distinguish capital previously existing from income taxable under the act.

There is only a superficial analogy between this case and the case of an allowance claimed for depreciation of a mining property through the removal of minerals, since we have held that owing to the peculiar nature of mining property its partial exhaustion attributable to the removal of ores cannot be regarded as depreciation within the meaning of the act. *Von Baumbach* v. *Sargent Land Co.*, 242 U. S. 503, 520, 524; *United States* v. *Biwabik Mining Co.*, *ante*, 116; *Goldfield Consolidated Mines Co.* v. *Scott*, *ante*, 126.

It should be added that in this case no question is raised as to whether, in apportioning the profits derived from a disposition of capital assets acquired before and converted after the act took effect, the division should be *pro rata*, according to the time elapsed, or should be based upon an inventory taken as of December 31, 1908. Plaintiff, in accordance with Treasury Regulations No. 31, T. D. 1578, January 4, 1910, and T. D. 1588, January

24, 1910, adopted the latter method, and the Government makes no contention as to the accuracy of the result thereby reached, under the stipulated facts, if our construction of the act be correct.

Judgment affirmed.